



# **Proceeding of The First International Conference on Multidisciplinary in Management**

**Hosted by:**

**The International College of  
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**USING THE SOFT SYSTEM METHODOLOGY FOR DESIGNING  
AN INTEGRATED AND INTER-FIRM KNOWLEDGE MANAGEMENT  
CAPABILITIES MATURITY MODEL IN HEALTH CARE ORGANIZATION**

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**ABSTRACT**

This paper proposes an integrated and inter-firm knowledge management capabilities maturity model (KMCMM), applied to the context of health organizations, namely to assist all stakeholders in their inter-firm context by allowing improved data sharing information in its many formats. But information technologies cannot guarantee increase of value by itself alone, it must be thru improved decision making assisted by a combination of the capabilities related to infrastructures, processes, and competences. The development of the organizational capabilities can be pictured on a maturity model and related to organizational performance. Such a maturity model is developed here, based on the literature and applied to health care.

**Keywords:** IT Value, Knowledge Management, Organizational Capabilities, Inter-firm Context, Resource-based View, Soft System Methodology.

# **USING THE SOFT SYSTEM METHODOLOGY FOR DESIGNING AN INTEGRATED AND INTER-FIRM KNOWLEDGE MANAGEMENT CAPABILITIES MATURITY MODEL IN HEALTH CARE ORGANIZATION**

## **1. INTRODUCTION**

In the last decades, research on the impact of knowledge management (KM) as a strategic resource on business performance has been mainly limited to strategic alignment (Mousavizadeh et al., 2015) and do not take into account the inter-firm context in which organization is evolving (Ashish, 2015, Mircea, 2015). This justify the need for actors to develop the organizational and inter-organizational knowledge capabilities in order to improve innovation (Berraies, 2015; Naggat, 2015) and business performance (Hasan, 2015), specially in the context of SME (Cruceru, 2015).

In the hospital and clinical sectors, knowledge sharing is important for reaching the hospital service and administration performance (Davis et al., 2015). But there is a lack of knowledge sharing between professionals in clinical aspects and between professionals and hospital administration because there exists within health care organizations a real need for new models, specific tools, and techniques of knowledge and information management (Illiashenko et al., 2015). In the same way, responsibilities and decisions making on healthcare should be facilitated and shared throughout the health organization and partners. To that end, this organization must, among others, develops means to get together medical know-why and know-how, protocols, good practice guides, and medical bibliographical references on easily accessible supports and facilitate their real time transmission within the organization and partners.

Otherwise, the literature establishes a link between maturity level in KM capabilities and organizational performance (Rheman, 2015). However, few works related to KM develop an integrated maturity model for KM capabilities which is using together KM infrastructures, KM processes, and KM competences. So using Soft System Methodology (SSM) this paper proposes an integrated KM capabilities maturity model (KMCMM). In this work, the concept of organizational capability is defined as a skill to carry out the deployment, combination, and coordination of resources and competences through various value flows in order to achieve strategic objectives such as sustainable competitive advantage and organizational performance measurement (Yin, 2015).

The paper is structured as following: first, we present a literature review; and second, using eight steps adapted from the Soft System Methodology (SSM), we try to find a consensus on the KM capabilities concept from academic experts and to design a KMCMM applied to the hospital and clinical contexts.

## 2. LITERATURE REVIEW

### 2.1 Organizational and inter-organizational capabilities and knowledge management

The concept of organizational and inter-firm capability is widely defined as a skill to carry out the deployment, combination, and coordination of resources and competences through various value flows in order to put forth the strategic objectives defined previously (Mircea, 2015). It is in the strategic approach of the resource-based view that the concept of organizational and inter-firm capability is better explained because this theory refers to the means which belong to the organization and which are necessary to perform the transformation of the inputs into outputs by developing the specific organizational capabilities. In this context, the concept of organizational and inter-firm capability is then referenced to the strategic application of organizational competences, their use, and their deployment in order to achieve the business goals, on the one hand, and to the firm abilities to assemble, integrate, and deploy the value resources in combination with other organizational resources in order to reach the business performance, on the other hand (Ordóñez de Pablos & Lytras, 2008). This position reinforces those of the literature supporting the fact that what is bringing the difference in the organizational performance is the way to which the organization manages the activities of its internal resources and not the control of its technical aspects or the market. This is why Amit and Schoemaker (1993) argue that the key capabilities, by definition, require strategic visions, time of development, and substantial investments. This would explain the partial success reached by some organizations which do not base their business strategies on the diversification of resources, but rather on the observation and the valorization of the internal resources and capabilities.

Thus, the concept of organizational and inter-firm capabilities is answering to the lack of theoretical assumptions in strategy, in general, and to the widespread theoretical thought that the fact to align a resource or its strategies with the business strategies is enough to guarantee the business performance, in particular. The development of the internal and inter-firm capabilities in accordance with the business objectives is more and more perceived as the only way to gain the sustainable competitive advantage and to support the business performance. In addition, concerning the KM capabilities, KM literature analyzes the concept of organizational capability following three main dimensions: knowledge infrastructures, knowledge processes, and knowledge competences.

### 2.2 Existing maturity models

Taking into account these three main dimensions of KM capabilities developed by Abou-Zeid (2003) and Chang and Ahn (2005), in the flow of Venkatraman (1994), we observe that the few models suggested in the literature refer to five maturity levels. They describe level 1 (the initial level; dimension of KM infrastructures) as a localized exploitation where the technological infrastructures are not integrated into the whole organization, but rather into local functions. It is actually a level where information technologies (IT) are emerging like an asset at the local level, but there is a misunderstanding between IT and the business world in the sense that IT development is not necessarily aligned with business objectives. At level 2, there is an internal desire of IT integration in order to support the transactions and take the decisions (e.g., the use of executive support systems (ESS) and decision support systems (DSS)) As for level 3, the step consists in establishing a good understanding between IT and the business world so that to ensure the alignment between IT strategies and business strategies. At level 4, IT are perceived as a strategic resource on which the organization develops its business strategy and vision (Bharadwaj, 2000). Thus, IT

architectures are integrated at the various organizational partners (Ye Du et al., 2008). Finally, at level 5, the IT infrastructure and the business are adapted to the various external partners of the organization.

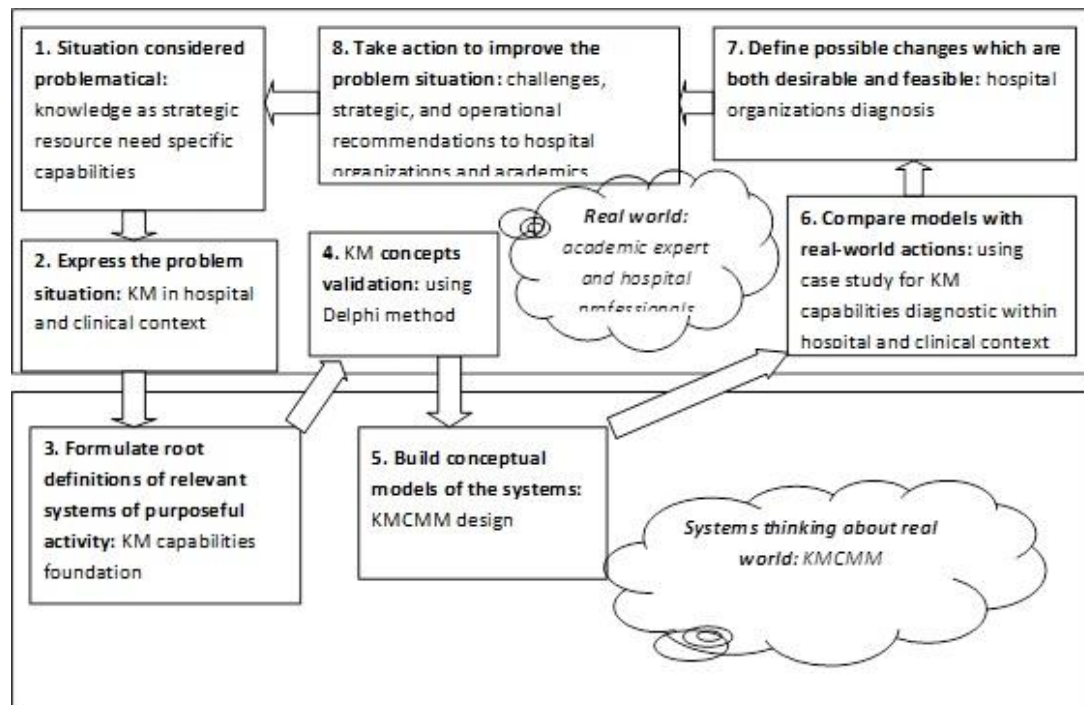
It is therefore important to know that the dimension of knowledge infrastructures includes IT which support the KM activities and the cultural KM infrastructures integrating elements such as the corporative vision and the organizational system values (Sandoval, 2015). In the second dimension of the organizational knowledge capabilities, KM processes are classified into three main categories: knowledge generation, knowledge mobilization, and knowledge application. With regard to business or IT processes, there are five maturity levels, namely in the view of Venkatraman (1994), Ramasubbu et al. (2008) and St-Amant and Renard (2004). At level 1, the exploitation of the resource processes is localized. The processes are at an early stage and slightly controlled because there is no formal process and thus the reaction to the situations is made up step by step: no defined priorities. At this level, the development of organizational capabilities is ad hoc and chaotic. At level 2, there is an internal integration of the processes (Mitchell, 2006) on a resource, the processes are structured and reproducible, and the organizational capabilities are expressed and put forth in definite and documented processes. At level 3, the organization reaches the level of business process reengineering (BPR), under the influence of a resource (Markus & Robey, 1988). It develops and exploits the processes relevant and integrated into the whole activities (Puri, 2007). At level 4, the organization controls its processes while being capable to measure them (Dekleva & Drehmer, 2001). It proceeds to the re-design of business networks on the resource basis. And its practices are documented and its results are quantitatively controllable and measurable. At level 5, the organization redefines its business mission which will be oriented on the resources. The business vision and the processes are elaborated with the partners in the inter-firm context (Ye Du et al., 2008), and the resource processes are continuously optimized and improved. Thus, knowledge can be used to develop new processes, new products, new services, etc., or to improve those existing (Abou-Zeid, 2003).

Finally, the third dimension is related to KM skills or competences. This dimension refers to the capability which can have an organization to facilitate the continuous process of knowledge generation and sharing. In addition, knowledge skills refer to the capability with which an organization could develop the human and cultural infrastructure and use the available KM technologies (Chang & Ahn, 2005). At level 1 of this dimension, people apply their knowledge with few motivation or rewards and the success depends on the individual efforts and competences given the major part of the necessary knowledge for task execution is inside people (Nonaka, 1994). At level 2, people integrate their knowledge and the organization improves individual, groups, and organizational efforts, competences, and knowledge. At level 3, people interiorize knowledge and interact with others for the achievement of a task or business objectives. At level 4, people coordinate their activities and share the risks and the rewards with their partners, and the organization identifies competences, knowledge, and the best practice so that to integrate them into its action processes. And, at level 5, the organization develops the leadership, ensures the career and staff training, and rewards its employees and the business partners that contribute to the process enrichment by the new knowledge, product improvement, and customer services (Saraf et al., 2007; Ye Du et al., 2008).

### 3. USING THE SOFT SYSTEM METHODOLOGY FOR DESIGNING THE KMCMM

First, as said in introduction, the definition of knowledge in the organizational and inter-organizational context is a very difficult task to perform (Spiegler, 2000). Also, organizational knowledge needs a good management using specific capabilities because the KM capabilities concept is one of the critical factors that help to rich organizational performance and sustained competitive advantage. So which KM capabilities the organization needs to develop and how to evaluate them? That is the question! In this paper, we use the eight steps of the SSM to try finding a consensus on the KM capabilities concept from academic experts and to design a KMCMM applied to the hospital and clinical contexts. In fact, we adapt the SSM steps in order to design the KMCMM, as depicted in Figure 1.

**Figure 1: The Soft System Methodology for Designing the KMCMM**



Source: adapted from Checkland (1981)

#### 3.1 Step 1: Finding the problematic situation

The literature clearly shows that knowledge is one of the strategic organizational resources likely to provide a sustainable competitive advantage and to promote the business performance (Barney, 1991). But the organizational KM is a very difficult task to perform as it requires the development of specific organizational capabilities to achieve a competitive advantage and the business performance.

#### 3.2 Step 2: Expressing the problematic situation

In the health sector, in general, and more particularly in the hospital and clinical sectors, KM is of a critical importance given the mass of data, information, and knowledge which flows there. A health organization is formed of a set of specialists who bring



healthcare to patients (Beveren, 2003). Clearly, this type of organization has advantage to develop capabilities to create, disseminate, and share knowledge throughout the organization in order to improve healthcare. Thus, the health organizations which manage and share knowledge could effectively note processing time reduction, costs reduction, return on investment, a high level of satisfaction, and a better medical and paramedical personal formation (Antrobus, 1997). Indeed, the medical sector is confronted to high levels of quality and care which require managing and sharing medical knowledge.

### **3.3 Step 3: Formulate root definitions of relevant systems of purposeful activity**

This step is primarily devoted to describe the KMCMM foundation. Indeed, in the literature review, it was noted that there was no integrated KMCMM that consider the Abou-Zeid's (2003) and Chang and Ahn's (2005) KM capabilities dimensions. But it seems evident that the organizations need a tool which could help them to establish the diagnosis of their KM capabilities given they want to know at which level they are currently and what to do. For this reason, the step 3 proposes some guiding principles which are the foundation of the KMCMM design. First, the development of the KMCMM is a process of organizational learning and knowledge accumulation over time which can be spread out in several stages. Second, the development of the KMCMM is seen as a set of skills to develop by the leader or the manager with an aim of guaranteeing, in combination with the other organizational resources, the deployment and the effective use of knowledge. Third, the KMCMM development is a strategic planning which requires strategic specific skills of KM in order to guarantee a strategic positioning of the organization to the assistance or a good organizational KM (Porter, 1985).

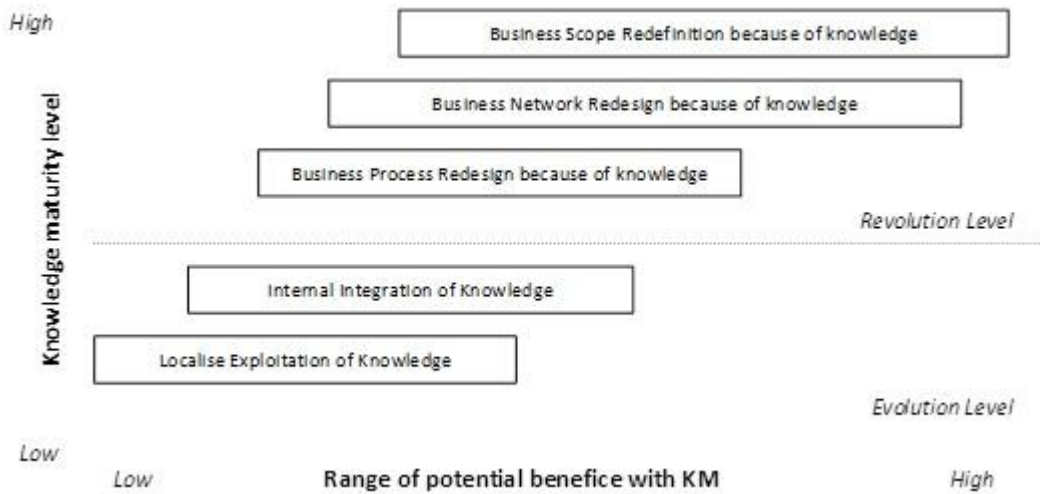
### **3.4 Step 4: KM concepts validation**

As conclusion of a Delphi investigation conducted from November 2006 to March 2007 to examine the elements defining the concept of KM capabilities, we noted that: (1) the concept of KM capabilities (KMC) is the sum of the whole organizational and inter-firm capacities related to the KM infrastructures, the KM processes, and the KM actors/people; (2) the KM infrastructures are the whole of organizational and inter-firm capacities related to the KM technological infrastructures and the KM structures; (3) the organizational and inter-firm capacities related to the KM processes are the whole of the organizational capacities related to the KM processes of knowledge generation, the KM processes of knowledge manipulation, and the KM processes of knowledge application; (4) the organizational and inter-firm capabilities related to the KM actors/people (or competences) are the whole of the organizational capabilities related to the KM culture, with the KM motivation, KM rewards, and KM inciting.

### **3.5 Step 5: Building conceptual models of what the system must do for each root definitions**

Considering the results of the Delphi investigation on academics, and in comparison to the models provided in the literature, while being inspired by the maturity model suggested by Venkatraman (1994), we suggest in Figure 2 a KMCMM which can reach an organization.

**Figure 2: Maturity Levels of the Organizations with KM**



Source: adapted from Venkatran (1994)

This model shows five maturity levels which an organization or an organizational network can reach or use with KM. It considers that, when the maturity level of KM capabilities in an organization is low, the awaited benefits are also low. The more the maturity level of KM capabilities in an organization is high, the more the awaited benefits would be also high. We can then see that the maturity levels of KM capabilities in an organization are regrouped in two main categories: first, the evolution levels (level 1: localized exploitation; and level 2: internal integration); and second, revolution levels (level 3: re-engineering; level 4: networks re-design (Riege & Lindsay, 2006); and level 5: redefinition of the business mission). The model proposed here has five maturity levels and it will be supported by a comparative table of the various characteristics of the existing KMCMM in order to highlight its relevance (see Table 1 and Table 2).

### 3.6 Step 6: Comparison of the conceptual models with the real world

In accordance with the sixth stage of the SSM that consists of comparing the ideal model conceptualized with the real-world actions (see Figure 1, Table 2, and Table 3), this step shows the KMCMM developed in the previous step to diagnose the level of maturity of two hospitals based in Kinshasa in Democratic Republic of Congo (DRC). This case study aimed at identifying the level of maturity reached by each of the two hospitals regarding the KM capabilities in order to produce, if necessary, the recommendations which are essential to help the development of the specific capabilities that these organizations need. Table 1 shows the results of the KMCMM applied in Libanga Hospital Center (LHC) and Refence Center of Kinshasa (RCK). The validation of the KMCMM in a particular context in Congo helped, on the one hand, to understand the place of a KMCMM in a health organization and, on the other hand, to perform a first qualitative validation of the model.

**Table 1: KMCMM Applied in LHC and RCK**

No	KM Capabilities Features (characteristics)	KMCMM Level Reached	
		LHC	RCK
1	Technology Infrastructures	1	1
2	Specific Structures	2	2
3	Knowledge Generation Processes	2	2
4	Knowledge Manipulation Processes	2	1
5	Knowledge Application Processes	2	1
6	KM Culture	2	1
7	KM Motivation	3	1
8	KM Rewards	2	1
9	KM Inciting	1	1

**3.7 Step 7: Define possible changes which are both desirable and feasible**

In accordance with the seventh stage of the adapted SSM which consists in defining the desirable and feasible changes (see Figure 1 and Table 2), this seventh step aims at emphasizing, for each of the nine characteristics of KM capabilities and according to the results discussed in the previous step, the weaknesses and challenges of each organization studied and for each dimension and characteristic of KM capabilities.

**Table 2: Sample of LHC Diagnosis**

Dimensions	Characteristics	LHC Diagnosis
KM Infrastructure	Technology Infrastructures	1- The professionals work manually and all of them use the paper medium; 2- The Web site does not facilitate the information exchange; 3- Absence of information and knowledge exchanges policies between professionals; 4- KM efforts duplications.
	Specific Structures	1- The medical daily meetings in the morning as KM structure are not sufficient to guarantee a significant long term KM support; 2- The daily meetings are a good point for a good knowledge management.
KM Processes	Knowledge Generation Processes	1- Absence of IT dedicated to KM and lack of their integration with medical technologies; 2- The knowledge exchanges are done verbally or they are consigned in the paper reports.
	Knowledge Manipulation Processes	1- The knowledge manipulation processes are limited to the only entities dedicated to the patient care and neither are documented nor evaluated.
	Knowledge Application Processes	1- The knowledge, information, and data sources are rudimentary and limited; 2- The rare knowledge exchanges between professionals are done at the work meetings and within training seminars.
KM Skills	KM Culture	1- The KM initiatives are not the result of a written and observed strategic thinking; 2- KM practices are

		isolated.
	KM Motivation	1- People and organizational entities are not motivated to KM.
	KM Rewards	1- Lack of clear policy regarding KM rewards.
	KM Inciting	1- Absence of KM incentive measures.

### 3.8 Step 8: Take action to improve the problematic situation.

In accordance with the eighth stage of the adapted SSM which consists in taking measures to improve the problematic situation (see Figure 1 and Table 3), this eighth and last step try to present the organizational challenges and strategic and operational recommendations for one of the health organizations studied. First, we briefly present the consolidated results of the cases of the hospitals studied. And second, we propose some recommendations to the organization in the form of challenges according to the best of the KMCMM and the literature.

**Table 3: Challenges, Strategic and Operational Recommendations to LHC**

<b>Dimension</b>	<b>Characteristics</b>	<b>Challenges, Strategic, and Operational Recommendations to LHC</b>
KM Infrastructures	Technology Infrastructures	1- To acquire the technological infrastructures; 2- To support internal technologies and contents integration; 3- To support technological integration with the partners.
	Specific Structures	To set up a permanent structure in order: 1- To facilitate the management of data, information, and knowledge; 2- To adapt the specific KM policies.
KM Processes	Knowledge Generation Processes	1- To support the total quality policies; 2- To rationalize and evaluate the KM operations effectiveness; 3- To ensure the business processes interdependence with the help of KM; 4- To create the specific business network processes with the help of KM.
	Knowledge Manipulation Processes	1- To develop a new business logic based on good practices of KM; 2- To adopt the effective knowledge manipulation systems; 3- To make sure that the KM processes are relevant, integrated, standard, coherent, and understood.
	Knowledge Application Processes	1- To identify, develop, and establish the integrated training programs of the high value fields; 2- To increase the knowledge sources within medical networks; 3- To evaluate the KM policies and practices.
KM Skills	KM Culture	1- To ensure of a permanent updating benchmark compared to the other health organizations; 2- To articulate its strategy and its vision on their design of the business networks with the help of KM; 3- To develop a new business vision supporting organizational transactions and decision making.

	KM Motivation	1- To lay down a KM motivation policy; 2- To support and encourage people and organizational entities to interact with others; 3- To set up the knowledge facilitation processes and to maintain them in continuous improvement.
	KM Rewards	1- To develop measurements to evaluate the added-values and the return by KM employee; 2- To lay down an organizational KM rewards policy; 3- To lay down a policy of risks sharing and KM rewards within organization and partners.
	KM Inciting	1- To set up a KM incentive policy; 2- To develop through the organization and its business partners the specific technical skills of technological infrastructures supporting KM; 3- To identify competences, knowledge, best practices, and to integrate them into its business processes.

#### 4. COMPARATIVE STUDY OF THE KMCMM WITH EXISTING MODELS

The KMCMM is a model designed on the basis of existing maturity models in order to meet their identified insufficiencies and the needs for application of the existing maturity models in the context of KM capabilities. In fact, it is often very difficult to use or apply as such, in the specific context of KM capabilities, the existing maturity models developed in IT or management. As shown in Table 4, none of the existing studies is taking into account at the same time the three dimensions of the KM capabilities. The capability maturity model integration (CMMI) is a model which would help to study the levels of maturity that an organization reach or can reach in the development of its KM processes. However, the CMMI is unaware of two other KMCMM dimensions: KM infrastructures and KM skills. This would seriously limit its adoption to measure the levels of maturity in KM capabilities. The previous maturity models stress the development of individual competences via the business processes because, according to these authors, the organization must identify competences, knowledge, and the best practices, and must integrate them into its action processes. This concern meets those of Peppart and Ward (2004) and those of the KMCMM which recommends a dimension on the level of maturity reached or to reach by an organization on its KM processes. It is what Luftman et al. (2004) support, while they recommend particularly the development of leadership, staff training, and improvement of product and customer services. However, on the contrary to the KMCMM, the model suggested by St-Amant and Renard (2004) do not take into account the dimensions of KM infrastructures and KM processes.

**Table 4: Comparative Study of the KMCMM with Existing KM Maturity Models**

Criteria (capabilities)	Do the following models include the capabilities of					Remarks
	KMCMM (Suggested model)	CEMM (Harigopa I and Satyadas, 2001)	DM-CMM (Kaner and Karni 2004)	The Siemens KMMM (Siemens, 2001)	KMMM (Klimko, 2001)	
Development, deployment, and use of KM infrastructures	YES	NO	NO	NO	NO	Organizational capabilities related to the KM infrastructures
Development, deployment, and use of KM processes	YES	YES	YES	YES	YES	Organizational capabilities related to the KM processes
Development, deployment, and use of KM skills	YES	NO	NO	NO	YES	Organizational capabilities related to the KM skills

The comparisons of the KMCMM with some maturity models proposed by the IT and management literature conclude that the KMCMM would be a model adapted to the diagnosis of KM capabilities. It is also noted that the previous models are the maturity models which help to evaluate the IT capabilities reached or which an organization can reach. From these models, Ramasubbu et al. (2008) stress the fact that the software engineering process is similar to the knowledge process that the KMCMM recommends. The previous models have the merit to approach the concept of the maturity model in a context of capabilities development and organizational competences in the field of management. The suggestion of KM capabilities in three dimensions brings an advanced level of analysis of the maturity level reached or that could reach an organization or organizational network by the development of their KM capabilities. So, the majority of the studies on the KM maturity models are related to the process and very few are interested in KM competences and KM infrastructures. In addition, to our knowledge, none of these studies takes into account at the same time the three dimensions of the KM capabilities.

## 5. CONCLUSION

Our aim in this paper was to understand the concept of KM capabilities and to suggest an integrated KMCMM taking into account the main capabilities in KM: KM infrastructures, KM processes, and KM skills. Thus, we can suggest some starting postulates from this paper. First, KM capabilities require the specific knowledge infrastructures which constitute the set of KM capabilities including IT supporting the knowledge activities and the KM culture including the organizational system of reward and incentive policies. Second, the development of the KMCMM is tributary of the unit of KM capabilities to the knowledge processes: knowledge generation, knowledge mobilization, and knowledge application. Third, the development of the KMCMM requires the set of KM capabilities specific to

knowledge skills: technical, organizational, and human. And finally, the development of the KMCMM can be observed only through a KM capabilities maturity model.

On the basis of our work presented in this paper, the following propositions are formulated. First, the development of the specific capabilities to the knowledge infrastructures determines organizational maturity in KM. In fact, the definition and deployment of new business and knowledge strategies are tributary of the technological infrastructures available to the organization. These infrastructures are related to IT infrastructures as well as the knowledge management systems (KMS) available or to acquire. Without adequate technological infrastructures and being able to support the establishment of new business and knowledge strategies, it would be difficult to reach the expected organizational performance. Second, the development of the specific capabilities to the knowledge processes determines organizational maturity in KM. Indeed, the development of the specific capabilities to the knowledge processes includes three main categories: processes of knowledge generation, processes of knowledge mobilization, and processes of knowledge application (Davenport, 1998). And third, the development of the specific capabilities to the knowledge skills determines organizational maturity in KM. In fact, the knowledge skills include the characteristics of knowledge processes which reflect the nature of the necessary competences to perform them.

Of course, the KMCMM proposed in this paper need to be more validated with further empirical studies for providing a standard maturity model within the KM capabilities field. Once more validated, it could be used as a diagnosis tool of KM capabilities and their strategic use within the organization. Thus, the manager will be capable to use the KMCMM for developing the KM capabilities in order to reach the business performance. On the other hand, the KMCMM could be used as a basis for further research on the subject by other researchers to develop the standardization of the KMCMM. Then, there is still a lot of work to do, and we will continue to investigate into this exciting new field in order to improve the organizational KM.



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# **FROM ADMINISTRATION THINKING TO MANAGEMENT POLICIES : CHANGES IN POST-WAR VIETNAM**

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## **ABSTRACT**

The most typical products of socialism include the collectivization in agriculture and the nationalization in industry and commerce, based on the centrally-planned regime. However, upon adopted in Vietnam, they were creatively bound with the “collective mastery” doctrine and the “economic complementarity” thesis: the former was naively applied to make the peasants masters of their collectives, cooperatives, and state; while the latter was rationally proposed to leverage the south’s enormous agricultural with light industrial potentials and the north’s plentiful mineral resources with heavy industrial capacity, thus promoting a surge of economic growth nationwide. The post-war crisis in Vietnamese administration thinking was featured by the debate between those who defined socialism as a centralized political and administrative control of economic production and exchange, versus those who felt the economic goals of socialism would be better achieved by allowing more autonomy for the enterprises, the producing households and individuals. Meanwhile, the collapse of the Soviet bloc and the failure of the Stalinist socialist model have jeopardized the war aftermath in Vietnam, thus urging for an overall renovation.

Consequently, a transitional country like Vietnam has engaged in the re-conceptualization of the state, from that of a controller to that of a supporter of private sector and a regulator of socio-economic activities. Concepts of development have also been reviewed and perceived as a multi-dimensional process involving the reorganization and reorientation of the entire economic and social systems. These changes in thinking have correspondingly led to the changes in the development model design, the leadership modality, and the management style, which strongly promoted a definitive turning from the pre-existing centrally-planned economy to the commodity economy under the market mechanism. In addition, an institutional adaptation and political reform of grassroots democracy in the framework of democratic centralism has enriched the perspective of the prevailing renovation known as “doi moi”.

Keywords: democratic centralism, collective mastery, administration thinking, Vietnam

## **FROM ADMINISTRATION THINKING TO MANAGEMENT POLICIES : CHANGES IN POST-WAR VIETNAM**

### **INTRODUCTION**

In Vietnam, the foreign Marxist-Leninist concepts such as exploitation, equality, and communal property were in fact part of the traditional popular culture (Fitzgerald, 1972; White, 1988). Even in the war aftermath, the formally accepted ideologies of development were still based on the prevailing long-standing thinking in the socialist countries which had been seen as genuine Marxism-Leninism. In essence, this thinking system was constituted from the sorted ideas of K. Marx, F. Engels, and V. Lenin in their classic works, and then interpreted in accordance to the subjective perception of the Soviet state leaders and leading economists. These ideas included: the re-deprivation of property from the deprivers, the class struggle as an impetus of the historical evolution, the proletariat dictatorship as a necessary tool of governance in the transitional period, the superiority of public ownership, the abolishment of the small-scale commodity production that could daily and hourly engender capitalism, the state monopoly in banking and foreign trade, the absolute superiority of socialism in execution of the centrally-planned mechanism not only over a country but also over the entire socialist system, the popular economic laws of socialism namely: improving ceaselessly the people's living standards, uplifting continuously the labor productivity, performing a balanced and planned development, ensuring a labor-based distribution, etc. (Dang, 2008).

Such rationalized thinking came into being in Vietnam as the result of a replication of outside experiences on the one hand; and of the wartime-styled thinking of administration on the other hand. This thinking model was seen as undoubtedly suitable to the wartime, but mistakenly applicable to the postwar situation for economic development without recognizing that the main reasons of the postwar economic backwardness had originated from the very existing administration thinking and the economic managerial mechanism.

With the changes in administration thinking in postwar Vietnam, the market economy has likely become a remedy for the centrally-planned economic failure. But the transition from the centrally-planned economy to a market economy has proven to be a difficult process that has profoundly affected the entire society. It was seen as an "institutional vacuum" (Murrell, 1992) of neither plan nor market where the former was going away but the latter has not taken over. In such a half-lighted situation, the reforms in agriculture had induced a nationwide renovation over all aspects of the socio-economic life. These reforms had ruined all the efforts achieved by administrative measures and commands, by the abolishment of private and individual economic factors, and by the establishment of the domination of the economic sectors based on the state and collective ownerships over the means of production. These reforms have led to the exercise of a multi-sector economy and the diversification of ownership types and business organization forms, thus recognizing the private ownership and the private economy. The reforms have abandoned the highly-subsidized and centralized bureaucratic mechanism, and have recognized the market and market mechanism of an open economy, which has become integrated into the regional and the global economy.

## **1. Pre-renovation administration thinking and economic management (1976-1980)**

### **1.1. Rationally-promoted economic development through revolutionary movements of socialist transformation**

The most typical socialist transformation movements during this period included the collectivization in agriculture and the nationalization in industry and commerce.

In a predominantly agricultural country like Vietnam, the socialist transformation movement of the individual peasant economy was essential for rapid restoration and further development of the war-devastated productive forces in agriculture, for releasing the agricultural productive forces from the shackles of the old production relations, and for ensuring the planned and proportionate development of industry and agriculture on the basis of the socialist economy (Chu et al., 1992; Bui, 2001). Only when the individual peasant economy was transformed along the socialist lines in the countryside could the country totally rid the peasants of all sources of exploitation and poverty and speedily increase agricultural production in a planned way. The objective of the collective economy was first and foremost to safeguard the interests of the farming member households against the competition, the challenges, and the threats from other strong agricultural enterprises (Dang, 2001). It was hoped that only on the basis of the socialist cooperative farming could the peasants' livelihood be rapidly stabilized and then their standard of living radically improved. Therefore, the most important revolutionary task was to ensure the peasants' ideological readiness to accept the collective economy (Tran, 1982) through a nationwide revolutionary movement.

Transformation of industry and commerce was also a necessity for building the socialist economic model. Theoretically, the justification of transformation implied that the revolution has come to a new stage – from the people's democratic-nationalistic revolution to the socialist revolution, i.e. from the struggle for the national liberation to the internal class struggle of “who wins whom” between capitalism and socialism.

Human beings were also considered the objects of the socialist transformation. In order to advocate this movement, the intellectuals and the government officers were, turn by turn, sent to the rural areas for the farming work. The justification implied a historical reason that in the highly-subsidized, administratively-bureaucratized, and centrally-planned economic model, the state was overstaffed. It was then natural and necessary to send them to the fields for rice production. Another reason was that they did not have much work to do when all the plans were worked out by the governmental consultancies without a need of their researches.

### **1.2. Agricultural collectivization with the doctrine of “collective mastery”**

The rationale for collectivization was that it was a key point in the entire socialist transformation which would lead to the total abolishment of exploitation, halt the spontaneous capitalist development in the rurality, and help support the socialist industrialization and consolidation of the worker-peasant alignment. The obvious faith was that the cooperatives were superior to other forms of organization. It was necessary to cooperate to overcome the negative spirit of the old working style and a small, individual, dispersed, local, narrow-minded and conservative production system. The agricultural socialist transformation implied the entire transformation of the production mode by turning private production into large-scale collective production. Therefore, it was necessary to

concentrate the labor forces and the production materials of all farmers to build up a new production mode with a new type of labor organization and labor division. Thus, more surplus extraction would lead to more socialist accumulation, more investment in production, and accelerated development for the good of the nation as a whole.

The doctrine of “collective mastery” was the pillar of collectivization. The spirit of collective ownership and self-government was popularly interpreted as: “It is necessary to make every cooperative member imbued with the spirit of his mastership and the spirit of consolidating cooperatives” (Ho, 2002: p.371). He also requested the Party to seriously settle the problem of “how to make all farmers clearly understand that they are masters of the collectives, masters of the cooperatives, and masters of the state” (Ho, 2002: p.377). But during the process of collectivization in Vietnam, the peasants felt alienated from their land and did not feel that they were the “collective masters” of their cooperatives, thus leading to the “masterless situation.” It expressed the partial political vacuum existing at the core of a political stalemate: neither peasants, nor the state, nor cooperative cadres were able to “master” the rural political economy (White, 1988). The right to collective mastery was announced but no attention was devoted to how the peasantry might implement this “right.” One fundamental question for reevaluating agricultural producing cooperatives was then raised: “Whose interests do they serve: the interests of the state, or of the cooperative members?” The verdict was not clear cut. While the government attempted to use cooperatives as a major instrument to increase central state control over the rural economy, the cooperative cadres and peasants were constrained in many ways by state regulations, although they have been all the time called “masters.”

Upon national liberation after the war in 1975, the northern collectivization model was implemented in the south so as to establish economic unification. However, the policies of socialist transformation failed to work well in the south. The southern farmers continued to farm individually rather than collectively. Meanwhile, a crisis in food procurement occurred in the north, and the outcomes of the people’s living standards were disappointing. The cooperative system was thus nation-wide bankrupted.

### **1.3. Great socialist production and the “economic complementarity” thesis**

The ideology of large-scale production was a common phenomenon in all the socialist countries, known as “gigantomania” (Dang, 2008). The theoretical rationale of this ideology stemmed from the belief that large scale made high efficiency. The country was therefore pushed to become a state of wealth by a socialist large-scale production whose productivity was much higher than that of capitalism or that of the individuals. In order to exercise such a socialist large-scale production, it was imperative to transform all the non-socialist economic components and merge them into two main economic components, i.e. state and collective. The national territory needed, therefore, to be restructured. The districts were made the economic foundation units, known as ‘economic fortresses.’ In many places, the long-standing traditional villages were demolished, and households were moved uphill to have their household land confiscated to make the cooperative farming land as large as thousands of hectares for tractor operation. Sixty provinces were thus merged into 29 larger ones.

During 1976-1980, the cooperative system in the north continued to be consolidated, enlarged, and reorganized towards centralization, specialization, and mechanization following the formula: mechanization + large-scale cooperative = large-scale socialist agricultural production (Nguyen, 2003). Correspondingly, village-size cooperatives were



merged into commune-size cooperatives and inter-commune cooperatives, and land was totally collectivized. With the war ending in 1975, the national economy was not influenced by the law of war-time any longer. The northern cultivation model of autarky and mono-crops countering commodity production and hindering rural development fell into a serious crisis, and was not accepted any longer even in the north. Therefore, the agricultural transformation in the south in 1976-1980 as a shortcut of northern collectivization with the purpose of turning the southern developed agriculture into a large-scale socialist agriculture, turned out to be a serious mistake.

In order to really unify the national economy, the “economic complementarity” thesis was proposed and interpreted in the government’s grand plan to leverage the physical endowments of the nation’s two halves. Its rationale implied the exchange between the north and the south: the south with its enormous agricultural and light industrial potentials, and the north with its mineral resources and heavy industrial capacity (Le, 1966), would promote a surge of economic growth and enable more rapid consolidation of the socialist production relations. However, following the departure of the Americans in 1975, the southern production capacity fell drastically. The government had to channel key materials from the north, which in turn reduced the incentives for the northern agriculture to develop and grow. And then the north finished up worse off (Beresford, 1988). As a matter of fact, the northern industry in 1975 was not in a state to carry out the leading role assigned to it by the “economic complementarity” thesis or by the orthodox socialist development theory. At the same time, those incentive goods which were channeled from the north to the south were not sufficient to keep the southern population’s living standards at the level to which they were accustomed. Thus, the proposed merger never came even close to succeeding. The postwar strategy of achieving economic complementarity by exchanging southern food surpluses for northern industrial goods could not, therefore, be implemented.

#### **1.4. The centrally-planned regime as backbone of the “in-kind economy”**

Corresponding to the orthodox thinking, it was imperative to practice a centrally-planned regime so that the socialist large-scale production could be operated in the best manner, the crises and anarchy could be avoided, and equality could be ensured. The essence of the central planning was the administratively direct coercion towards all socio-economic activities through mandatory decisions from the central level (Ngo, 2008). Plans were considered the second political program of the Party. The state used planning as the iron hand to control all the input and output resources of the production process (Dang, 2008) in a closed “in-kind economy.” As a result of the over-centralized planning, economic measures were replaced by administrative measures in managing production (Institute of Economic Studies, 1961).

Socialism is a system whereby reimbursement is always in kind to meet the needs of the society and to match the norms of production. It was agreed that the idea of the “in-kind economy” with the highlighted “value of use” was induced from a humanitarian point of view. However, it has soon become challenged with the interests of different social groups. The product sellers failed to get from the society a reasonable compensation for the production costs and their devoted efforts. Hence, the production yield decreased, the economic efficiency reduced, and the economic interests conflicted with each other.

The market, in such society, stayed outside the state price system. Accordingly, almost of the national economic plans became the plans of in-kind balance. In the production

side, the planned norms included: how many, how much, and which material was to be given for the production; and in turn, how many pieces of products were to be produced. In the consumption side, it was not a concern of how big a salary was, rather how many kilograms of rice, how many metres of cloth, etc. was to be generated. The most important prices included the prices of selling productive materials and the prices of purchasing agricultural products. Under the centrally-planned principles, the cooperatives were obliged to sell their produce to the state at the planned prices and with the planned quantities. These prices were much lower than the market prices. In order to make sure the cooperatives could manage their planned obligations, the state assisted them with the necessary productive materials and consumer goods.

The state totally monopolized the external economic management. All the import and export activities were carried out by the state companies. The exchange rates between local and foreign currencies were determined by the state without taking into account the market rates. Accordingly, all the differences of expenditures of the local currency in import or export, either higher or lower than the practical exchange rates, would be adjusted by the state through the state budgeting. The state would also compensate for the losses.

### **1.5. Consequences of the wartime-styled thinking of administration**

In the war aftermath, the rural areas in the north were characterized by local self-sufficiency and stagnating productivity. Part of the problem also lay in the industrial sector and the development strategy. Investment and imported goods were allocated via administrative methods, the goal of which had been largely dominated by the requirements of war production and the desire of the leadership to create a heavy industrial base. Priority had not been given to satisfying agriculture's demand for modern inputs and consumer goods. Low official purchase prices for grain were also responsible for discouraging commoditization of grain, since they adversely affected the returns of collective farming compared to household subsistence farming. Inability of the agricultural sector to supply sufficient food grain to feed urban population and to supply raw materials to industry meant that considerable quantities of rice had to be imported. As a result of the heavy industry priority strategy, investment resources were tied up in construction of large-scale plants, with very long gestation lags which relied heavily on imported inputs of capital equipment and raw material (Beresford, 1988; White, 1988).

Under a system of centralized resource allocation, there was a well-known tendency for enterprises to try to secure their own sources of inputs, leading to the hoarding of productive materials, which reduced economies of scale, wasted scarce resources, and slowed down the growth rate. Shortages were thereby reinforced (Kornai, 1982). In terms of economic efficiency, the cooperative's production continued to decline and the returns were not commensurate with the pains taken by the peasants or the investment made by the state in capital projects, material supply, and new techniques applied in agriculture. In many places, a series of cooperatives collapsed or were only carrying out activities for form's sake (Nhandan Daily, 1974).

The economic situation in the south was quite different. Supported largely by the American military regime, the private sector had emerged as a key economic driver during the war. In the commercial sector alone, 60 thousand households dealt in manufactured goods – equal to 26 percent of all dealers. Another 30 thousand households engaged in other businesses. Small- and medium-size companies producing light manufactured goods

dominated industry. Beginning in 1976, a number of 1,500 large- and medium-size private manufacturers had been reorganized into state-run enterprises. Many were forced to accept joint ventures with the state, whilst smaller companies were transformed into cooperatives. A total of 150,000 workers in these targeted enterprises had been affected by the transformation, which equaled 70 percent of the labor force working in the existing private enterprises (Nhandan Daily, 1979). With respect to land and agricultural reforms, shortly after the national reunification, the government forced the southern farmers to join farming cooperatives. Given the south's more liberal and capitalist environment, and with benefit of hindsight, the decision to northernize the south might have been doomed to fail from the start.

The findings from reality proved that the model of collectivized cooperatives applied to the south which coped with the locally typical socio-economic relationships had soon exposed its irrationality and inefficiency. The shortcomings of the collectivized cooperatives in the north were gradually revealed during the period of nearly 20 years, nevertheless their limitations and weaknesses were quickly exposed in just five years in the south. On the one hand, the northern model was introduced to the south when coming to its ebb with various illnesses; and on the other hand, the different southern socio-economic conditions, as above-mentioned, sped up the decomposition of the out-of-date collectivized cooperative model. Consequently, agricultural production promptly plummeted, contributing to near-famine conditions. Over most of the period 1976-1980, consumer goods and basic staples were in short supply. In May 1978, a new currency was introduced, which helped erode and diminish the capital assets and savings of the entrepreneurs and the middle class in the south. State planning objectives stifled growth and output in the south. While the infrastructure destroyed in the war hampered the internal trade. Prices were unstable, unemployment rose, budget deficit widened, and foreign aid vanished (Quinlan, 1995).

In conclusion, the initial collectivization drive in the south, instead of achieving peasant integration into the national economy via administrative control and state procurement of surpluses, encountered passive resistance. The same problems with labor mobilization and low labor productivity on collective fields in the north also began to appear in the south. Not only did peasants concentrate most of their effort on the household economy, but they increasingly resisted the collectivization movement. Given the importance of the southern agriculture in the overall strategy of food self-sufficiency, this was a factor which contributed to the serious national economic crisis of 1978-1980. At this moment, the crisis has gone beyond the agricultural cooperatives and impacted all the activities of the entire national economy.

In agriculture, the national production has seriously reduced. Seventy percent of the collectivized tractors became out of order without spare parts for reparation and 1.8 million hectares out of the total of 7 million hectares of the cultivated land was left fallow (Tran, 2006). The planned target of the rice outcome was 21 million tons for 1980, but it turned out to be just 11.647.4 million tons, which was not as much as 11.827.2 million tons in 1976 (GSO, 1986). The *per capita* outcome decreased from 211 kilograms of rice in 1976 to 157 kilograms in 1980. The delivered food to the state decreased from 2.04 million tons in 1976 to 1.45 million tons in 1979. Especially in the southern granary, the reduction was very serious which was from 1.1 million tons in 1976 to 800,000 tons in 1979. The state had, therefore, to import 1.57 million tons of food – the biggest imported amount ever since (GSO, 1981).

In respect of commodity distribution and circulation, selling and purchasing became impossible due to congestion in the selling-purchasing mechanism. In this congestion, a free market emerged and developed as the result of the natural reaction to the insufficiency of commodities. Farmers sold their products to the free market in order to afford the input materials. The planned economy has been gradually and partially taken over by the private economy and the free market. There appeared a symbiosis relationship between the organized market and the free market, between the state economy and the private economy.

In industry, around 30 percent of the total factories had to cancel production. The rest of them operated with only 40-50 percent of the designed capacity. Many workers had to lay off with 70 percent of salary. The state enterprises had to sell a part of their produce to the market for the payment of the productive materials and worker salaries. There were factories paying their workers with the products, such as tooth-paste, children’s clothes, instant noodle, cigarettes, etc. It was these kinds of “salaries” that had generated the free market when they were sold for their subsistence (Dang, 2008).

In transportation, the state could only provide about 30-40 percent of the gasoline needed and 10-12 percent of the spare parts needed for the vehicles. Thus only 50-60 percent of the vehicles could manage to operate (Dang, 2008).

During 1976-1980, the GDP increase got only 1.4 percent, and the GNP increase got 0.4 percent, whereas the national increased population reached 2.24 percent (GSO, 1981).

**Table 1: Comparison of the increases of GDP and GNP, 1977-1980**

<b>Year</b>	<b>GDP increase (%)</b>	<b>GNP increase (%)</b>
1977	4.4	2.8
1978	4.0	2.3
1979	-1.7	-2.0
1980	-1.0	-1.4
Yearly average	1.4	0.4

Source: GSO (1981)

## **2. Embryonically-renovated thinking of administration in dilemmatic situation (1981-1985)**

### **2.1 Debates of thinking between the ideologues and the pragmatists**

In Vietnam, for the first time, many of the Party’s directives were considered “too subjective and impractical.” And the issue of the roles of plan and market was finally opened to discussion.

During this time, there appeared a crisis in administration thinking: the old thinking faced with the severe challenges of reality and failed to settle the emerging puzzles. Its inertia, however, was still very strong. Meanwhile, the new thinking was still in embryo. There existed a dilemma of the economic management approaches of either returning to the centrally-planned regime or entering upon a new model of the market economy.

Correspondingly, there appeared two broad tendencies within the leadership (Marr, 1988), as follows:

i) On one side was the older revolutionary generation, whose thinking misconceived of socialism. They wanted to consolidate the system instituted in the north since the late 1950's and expand it to the south with hardly any modifications. In their thinking, the formative experience of economics was the use of political mobilization and political-administrative control through the apparatus of the party and the state in order to bring under control an economy controlled by hostile forces, i.e. imperialists, capitalists, and grain speculators.

ii) On the other side was the younger generation, who felt that certain economic policies long considered the only socialist route to economic development needed to be changed. Core socialist policies – central planning, state price controls, priority to heavy industry, collectivization as the vehicle for state procurement of agricultural produce, and egalitarian wage and distribution policies – were all increasingly called into question. They highlighted market institutions and market prices as economic levers. This was due to the winds of the ideological change blowing over socialist countries throughout the world, as well as the response to the specific economic crisis in Vietnam.

Thus, the war aftermath debate has been between those that defined socialism as entailing maximum centralized political and administrative control of economic production and exchange, versus those that felt that the economic goals of socialism, including both production and equity, could be better achieved by allowing more autonomy in economic decision-making for the socialist enterprises, as well as the producing households and individuals. In terms of the financial system, the centralized version of socialism advocated by the stubborn think-tank was “the state bureaucratic finance,” whereas “the socialist cost accounting” proposed by the reformists allowed for more autonomy for producing units, i.e. more decentralized and more democratic. With respect to agriculture, the socialist transition entailed a constant struggle between the two roads – collective production versus private production, large-scale socialist production versus small-scattered production. The new orthodoxy appeared as a combination of both central control and basic unit autonomy, which was the idea of “democratic centralism,” contrary to the “bureaucratic centralism” (Le & Pham, 1975).

During this time, the economy itself has obviously been the major internal problem, including economic recovery, economic reunification, economic development, and economic reform. The above-said debates within the Vietnamese leadership which have been public knowledge since August 1979 have been predominantly characterized in the West as between “the ideologues and pragmatists” or “hardliners and moderates” (Tan, 1985). This often carried the underlying assumption that, although “ideologues” or “hardliners” struggled to keep faith with the socialist orthodoxy, the Party was eventually forced “pragmatically” to face the capitalist facts of economic reality. This approach was not limited to studies of Vietnam. In a study of economic reforms in the USSR and Eastern Europe, J. Wilczynski has noted the polemical and ideological nature of the reform discussions: “Many cynics have taken delight in interpreting the reforms as an admission on the part of socialism of its defects and an acknowledgement of the superiority of capitalism by the adoption of several features of the rival system. Some, in their naivety, have gone even further – depicting the reforms as a return to capitalism” (Wilczynski, 1972).

There appeared, however, in the reunified Vietnam, great problems, also obstacles, in the orthodox thinking: the first problem – was it possible to continuously carry out the revolution of production relations when all the economic sectors were equally promoted to development? The second problem – what would happen to the planned economy if the free market was to be developed? The further problem was whether it was a retreat of socialism or an erosion of the socialist superiority. However, in the half-lighted tunnel of the pre-renovation period, the Vietnamese think-tanks either willingly or reluctantly considered it as a concession to capitalism along the lines of Lenin’s New Economic Policy (NEP).

In 1979, various NEP training courses for more than 1,000 government officials of mid- and high-level organs were seen as the catalysis of the new thinking among the leading administrators. Many of other training courses were also organized for the high-ranking administrators, including ministers, deputy ministers, provincial governors, etc. In these courses, the opposite ideas of the socialist attributes as well as the renewed ideas of the market economy were exposed. The findings from these NEP training courses were the direct criticisms of the central planning, the agricultural cooperative mode, the transformation of the non-socialist production relations, and the heavily-subsidized mechanism of distribution and circulation, especially the agricultural product procurement.

The NEP ideologies have become a blow of fresh air breaking through the thinking of the rigidly- and conservatively-minded think-tanks. In respect of the central planning, according to S. Abalkin, Director of the USSR Economics Academy, and later, Deputy Chairman of the USSR Council of Ministers, it was a serious mistake of the old development model to have rejected the market, and to have rationally designed and managed the plans. He insisted that the plans must be based on the market in order to set up the suitable norms as well as to manage the plan implementation. He stated: “In the past, the plan appeared as a file full of norms, but now as a file full of contracts. Contracts constitute the market, and set the starting point of the plan.” In terms of agriculture, Igor Tikhonov, academician of the USSR Academy of Agriculture, determined that Lenin’s idea was quite different from Stalin’s policy of building the collective and state farms. He stated that such style of management was only good for the state management, not good for the farmers, and led to economic inefficiency. As far as the multi-sector economy was concerned, originating from Lenin’s NEP doctrine, M. Kulikov, suggested the promotion of the private economic sector, the individual economic sector, the capitalist economic sector, and the foreign capitalist economic sector. These new ideas from the well-known characters have greatly contributed to the formation of the new thinking within the circle of the Vietnamese administrators. But most importantly, they have made themselves the amulets to protect the Vietnamese reformists in the exercise of the renovation.

The reformists argued that the market existence was natural, so did the market prices. The hardships in the previous time were not induced from the spontaneous impacts of the market, but from the rational thinking that unacknowledged the market, i.e. tried to abolish the unabolishable thing. This way of treatment towards the market and the market prices exhibited the leftist deviation and extremism, which generated an ostracism or discrimination complex of the private ownership and the market mechanism. With the renewed thinking, it was argued that to flee away from the market or to resist against the market would mean a return to the subsidized bureaucratic regime. The so-called “organized market” was none other than an artificial and authoritarian institution (Dao, 1986). In the realm of administration thinking of this time, such an idea came like a thunderbolt. It was then strongly opposed by the opposite think-tanks that socialism would be collapsed by this

deviation approach, the public ownership would be taken over by the private ownership, and the planning regime would be replaced by the market mechanism. These people have always led an explanation that all of the shortcomings and failures of the economic production and circulation originated not from the model itself, but from the implementation of the model, from the implementers of the model, the awareness of the populace, the remnants of the old regimes, and the sabotages of the resisters. However, a handful of administrators realized that the economic problems in those days induced, not only from such objective reasons, but from the managerial mechanism and the model itself. It was a bold change of thinking to impute these defects to those very mechanism and model. Nevertheless, the thinking of economic administration in this half-lighted situation of pre-renovation was still asynchronous and inconsistent.

To ensure a sound direction, the party espoused both Marxism – Leninism and Ho Chi Minh thoughts which served as guidance for the activities of the party and state. Since the party's foundation, the key ideology has been Marxism – Leninism, but since the introduction of a mixed economy in the late 1980s, it has lost its monopolistic ideological and moral legitimacy. The party's claim to legitimacy was retained after the collapse of communism in 1989 and the dissolution of the Soviet Union in 1991 by its commitment to Ho Chi Minh's thoughts (Quinn-Judge, 2003). While some claimed that his thought was used as a veil for the party leadership since they have stopped believing in communism, others saw it as a political umbrella to introduce non-socialist ideas and policies without challenging socialist legality.

## **2.2 The “groping” economic policies**

The legacies of underdevelopment, foreign occupation, wartime destruction, foreign aid dependency, and high expectations were not seen any longer the only problems facing the postwar Vietnam. Instead, the most serious problem was the counter-productive economic policies (Marr, 1988). The initial renewal of economic policies was hence put forth in the 1981-1985 Third Five-Year Plan.

### **2.2.1 Contracts in agriculture**

In macro-economic management, readjustment of the investment structure in the national economy shifted from “giving priority to heavy industry development” to “taking agriculture as the foremost front” (Pham et al., 2000). Being faced with an impasse in the reorganization of agricultural cooperatives in the north, the impediments in the campaign for agricultural collectivization in the south, and the failure to attain a large number of objectives of the 1976-1980 Five-year Plan, the state decided to readjust some key socio-economic development policies. Various solutions related to several urgent socio-economic problems were set forward, including: recognizing the existence of a multiple-sector economy with multiple-ownership forms, lessening the centralized management mechanism in agricultural cooperatives, allowing member households to borrow cooperative land for production, regulating agricultural product procurement prices, abolishing the ratio-based food distribution, recognizing the member household economy as an integrated element of the socialist economy, etc.

The cooperatives were encouraged to contract out land not directly used or left fallow between harvests. But in practice they tended to contract out even the farming land. The initial trial was attempted in Doan Xa cooperative of Do Son district, Hai Phong. Due to the upgrade to the high-level cooperative, the rice yield achieved only 60 kilograms per *sao* or



360m<sup>2</sup>. There were 7,000 heads in the cooperative with the harvested outcome of only 160 tons of rice, equivalent to only one-sixth of the ordinary outcome. Nevertheless, it was the cooperative's obligation to deliver 100 tons of rice to the state. The rest of 60 tons was distributed to 7,000 mouths, thus *per capita* outcome was less than one kilogram for 6 months. The crops in 1977 were a complete failure because of drought. So people did whatever they could to feed themselves, even went begging. It was impossible for the production teams to mobilize the workforce any longer. The cooperative management board therefore decided to allot each family half a *sao* or 180m<sup>2</sup> in order to be able to cultivate the main season rice. The results went beyond all expectations: people worked with unusual zeal, staying in the fields from dawn till dusk; the crops were carefully looked after; and the deliveries to the cooperative met all quotas and were over schedule. On the basis of this success, the loaned area doubled in 1978 and increased fourfold in 1979. In order to avoid the criticism that lending land to the peasants would lead to the destruction of the cooperative, important tasks such as land tilling and preparation, water control, fertilizer distribution, and measures to control insect/pest damage remained the responsibility of the cooperative. However, Doan Xa's secret to success turned out to be contrary to the tenets of socialism: Doan Xa was secretly applying "blanket contracting" – a form of land leasing to the peasants, a measure which had been severely condemned a decade ago as harmful to the position of the cooperatives and to socialism in the countryside. At first it was kept in secret, but then it was revealed that the cooperative had loaned about one hundred hectares of farming land to the peasants. In 1980, the entire cultivated area was loaned to the peasants. Real output reached 1,210 tons as compared with 740 tons in 1977, and the value of agricultural and handicraft produce shot up from 424,000 *dong* to 1,100,000 *dong*. *Per capita* rice ration went up from 6.4 kilograms to 15 kilograms (Tetsusaburo, 1984).

In 1980, most of the cooperatives in Hai Phong adopted the new contract system and the average yield of the winter rice reached 2,300 kilograms per hectare, compared with 1,880 kilograms per hectare over the northern provinces. The annual gross food product increased by 6.3 percent compared with 1979, and the obligation of food delivery to the state reached beyond the planned target by 299 tons (Truong, 1999). In Do Son district alone, 82 tons of rice was added to the welfare after obligation (Vo, 1981).

Thus, the secretly conducted contract developed and became semi-opened. The government then legalized the "household contract" to non-rice farming. But not being pleased with the household contract for non-rice farming, the cooperatives in some places tried a secret household contract for rice farming. In January 1981, the Party Secretariat released Directive 100, known as "Contract 100," on contracting products to laborers, which allowed the household contract for rice production. Directive 100 clearly pointed out the purpose of relating the end product to the peasants, which included developing production and enhancing economic efficiency, stimulating labor productivity, utilizing production materials, applying technical progress, economizing production costs, improving the income and living standards of the peasants, increasing accumulation for cooperatives, and delivering more agricultural products to the state (Truong, 1999). Turning from leading a centralized management and unified equilibrium distribution to allowing the cooperative members to invest directly in their production and enjoying a part of their outcome represented a significant change.

Contract 100 in agriculture was seen as the initial breakthrough into the collectivization model, ushering in a new modality of work with peasant participation in various stages of production and management of the cooperatives. Instead of collective labor

under teams or brigades, household labor became involved in certain stages of agricultural production for the targeted outcome product commensurate with the fixed costs of fertilizer, seedlings, and labor work. The driving force of Contract 100 was that the peasant households were given back the right to control some of the stages in the farm production process, especially those related to the end product (Pham et al., 2000). With this contract system, rice production was divided into eight areas of work. In principle, only the three work areas of the individual household were to be under the contract system, but in practice all the eight areas have been contracted out, due to the cooperatives' unresponsive and bad services.

With the product contract system being put into effect, cooperatives made contracts not only for land but for the required amount of produce to be delivered during fixed three-year to five-year terms. As an impetus of development, Contract 100 encouraged the farmer households intensively to invest capital and labor force in agricultural production on collective land in order to enjoy the product portion beyond the contracted terms. In 1981-1985, a sum of 4.9 billion *dong* was invested by the farmer households for this purpose. The food outcome of the winter-spring crop in 1981 in the north increased averagely 15 percent, and 25-30 percent or even 40 percent in some places. The labor force in production increased more than 10 percent, and the labor time increased 25-30 percent (Vo, 2002).

Contract 100 was seen as the golden key to opening a new development period in the rural areas (Nguyen, 2001). Although the state investment in agriculture in 1981-1985 consisted of only 41.5 percent, and material supply to agricultural production represented only 58 percent of those in 1976-1980, agricultural production still had increased remarkably. The gross agricultural product increased by 6 percent, and national income in agriculture increased by 5.6 percent. The paddy equivalent food product increased by 27 percent, and rice yield increased by 23.8 percent *per annum*. Food *per capita* increased steadily: from 273 kilograms in 1981, to 299 kilograms in 1982, then 296 kilograms in 1983, 303 kilograms in 1984, and 304 kilograms in 1985. A report from the General Statistics Office showed that 92 percent of peasant households overcame the contracted target for the 1984-1985 winter-spring crop. The actual yield increased from 5 to 20 percent compared with the contracted yield (Nguyen, 1995). In the 1981-1985 Five-Year Plan, the food production averaged 16.9 million tons per year compared to 13.4 million tons during 1976-1980.

During this time, a series of government directives and decisions were put out with the intention to inspire more production from various economic units and greater desire to work, especially amongst the farmers. Important among these were a directive in February 1980 by the government to promote and strengthen the two-way contract system, and a decision in October 1980 for the stabilization of grain delivery obligation.

At the macro level, the state shifted from a focus on procurement as the priority to a focus on raising production. The state introduced a form of grain-fertilizer barter system in which those who sold to the state and met quotas received preferential access to inputs. But the effectiveness of this depended on fertilizer availability, which was constrained by domestic production and an extreme foreign exchange shortage. As these directives fixed tax payment and quotas on agricultural deliveries for the five years, peasants, especially the southern ones that remained largely independent, began to feel a new sense of security, which inspired them to redouble their production efforts. The important point to note is the government's decision to allow agricultural cooperatives and enterprises processing agricultural goods to draw up directly between themselves two-way contracts for the purchase of agricultural goods as well as for the supply of foodstuffs, fertilizers, insecticides,

and manufactured goods. This two-way contract system was also to be extended to transactions the state had with agricultural cooperatives and with individual farmers. The noteworthy feature of this contract system was that after fulfilling their fixed quotas to the state, cooperatives and farmers would be free to dispose of their remaining surplus as they liked. The state would no longer be able to appropriate indiscriminately their agricultural products. The state trading organizations also brought their purchasing prices closer to those of the market in order better to compete with the private operating merchants. Transactions between the state and the producers for surplus production became negotiated price dealings which in effect meant the going market rates.

### **2.2.2. From the “fence-breaking” in commodity circulation to the official price reforms**

In terms of the price system, criticism was that the State Price Committee was quite wrong in fixing the prices, without taking into account the market situation, the shortcomings of the state’s input materials provisions, and the increased needs of the cooperative farmers. The purchasing price of the agricultural products needed to be raised for the agricultural reproduction and industrial development. Vo Van Kiet, before being the Prime Minister, had known as a renewed think-tank. He daringly allowed the South Food Company to “break the fence” in supplying rice for Ho Chi Minh city. At that time, the “directive” price of the State Price Committee was 0.52 *dong* per kilogram of rice which was too low compared with the cost price, thus inducing the failure in the procurement. There was no rice for sale, but it was abundant in the farmers’ barns. He then decided to allow the company to purchase rice at the negotiated prices in order to resell in the city. As a result of this “fence breaking,” the food procurement increased obviously. In An Giang province, for example, only 50,000 tons of food per year (half of the planned amount) was purchased at the “directive” prices; but 162,000 tons of food (in excess of 62,000 tons) was purchased in 1980 at the negotiated prices.

The first price reform was officially implemented with the release of various government’s texts: Decision on May 29<sup>th</sup> 1981 on a new retail price system, according to which the prices of most of the commodities were raised by 10 times, i.e. closer to the national or international market prices; Decision on July 5<sup>th</sup> 1981 on the new wholesale price system of the raw materials; Decision on September 26<sup>th</sup> 1981 on a new price policy for agricultural product procurement. Besides, the government’s Decision 28 QD/CP in September 1982 totally abolished the obligation of pork selling to the state. At the same time, the government raised the prices at which it sold equipments, fertilizer, and agricultural chemicals to the peasants. Prior to that, there appeared a different situation when the government’s purchase and selling prices were exceedingly low and the purchase methods were strictly coercive. The followings are some of the examples of these price distortions: the government sold urea fertilizer for the agricultural production for 0.5 *dong* per kilogram while it was 10 *dong* per kilogram in the market. Soybean was sold for 10 *dong* per kilogram in the market, but the state bought it for 2 *dong*. As a result, between 1976 and 1980, the state was able to buy up averagely only 2 million tons of rice and other grains annually. During those 5 years, the government had to import from 1.5 to 2 million tons of grain annually to make up for the domestic shortfall (Nguyen, 2003).

From 1981, the state began a two-tiered price mechanism for the purchase of agricultural goods from the peasants: at the lower level were the fixed prices for the obligatory quotas of goods that had to be delivered to the state; at the upper level were the prices negotiated between the state and the producers on the surplus goods produced in excess of the quotas. These latter prices stayed closer to the free market level. Listed below

are examples of the new price increases that the government set for paddy rice that had to be delivered to the state.

**Table 2: Wholesale Prices of Raw Materials**

Items	Unit price	Pre-adjusted price rate	Post-adjusted price rate	Increase rate (times)
Gasoline A72-76	<i>dong/ton</i>	875	6,500	7.42
Diesel	<i>dong/ton</i>	45	5,000	11.1
Coal	<i>dong/ton</i>	53	400	7.5
Electric power	<i>dong/KWh</i>	100	1,000	10
Cement	<i>dong/ton</i>	166	1,800	10.8
Cotton fibre	<i>dong/ton</i>	630	4,000	6.3
Steel (d = 6)	<i>dong/ton</i>	950	5,250	5.52
Urea fertilizer	<i>dong/ton</i>	520	7,500	14.4

Source: Phan (1992)

**Table 3: The Obligated Prices of Rice Purchase in Two-way Economic Contract (*dong/kg*)**

Region	Pre-adjusted price rate	Post-adjusted price rate	Increase rate (times)
Red River Delta	0.52-0.56	2.50-2.75	4.9
Mountainous regions	0.65-0.72	3.30-3.50	5.0
Mid-land	0.56-0.60	2.75-3.00	5.1
Central plain	0.60-0.65	3.00-3.50	5.3
Mekong River Delta	0.50-0.56	2.50	4.4

Source: Phan (1992)

### 2.2.3. “Untying” state enterprises and recognition of their autonomy in business and production

The previous economic development model was actually a non-economic model. So the ideas of “untying” in production was known as one of the most significant breakthroughs in economic administration thinking which was interpreted as an acceptance of the market laws, the multi-sector economy, and the adjustment of the price system and the price management. It was obvious that “opening”, “bursting out”, or “untying” were not leading to the loss of socialism, but on the contrary, saved the national economy and the people’s lives. It was also mistaken to hastily rush to put an end to the transitional period and quickly enter the socialist development, thus leading to neglect the law of value, to reject the natural existence of the commodity-market relationships, to abolish as soon as possible all the non-socialist economic sectors whereas the foundation of their existence was still available. The most important thinking to be renewed in this time was the turning from monitoring the economy by means of administrative orders to monitoring the economy corresponding to the natural laws (Tran, 2002) and the recognition of the laws and the operations of commodity production (Nguyen, 2008). It was remarked by an open-minded leading economist and administrator: “Fence breaking or untying is in fact like to thrust a small hole through the fence or the wall. When a small hole is accepted, it is then enlarged to make a window. When

the window is accepted, it is further enlarged to make a door. This is the process of reform in Vietnam” (Tran, 1995).

Attacking on the backbone of the socialist economic regime, i.e. the central planning, in January 1981, the government’s Decision 25/CP was enacted that acknowledged the three-plan system of the state enterprises. This three-plan program included the plan for the state – known as Plan 1, the plan for the joint venture with other business partners – known as Plan 2, and the plan for the market – known as Plan 3. With this decision, the joint ventures and associated affairs previously known as colluded have now been legalized. Especially with Plan 3, the state enterprises were, for the first time, permitted to produce commodities to serve the free market. Thus, planning was not seen as the unique method of economic development; rather the plans were seen as to closely relate to the market; the planned market was seen as to coordinate with the unplanned market; the private economy was seen to be more positive; the optimal norm of the policy measurement was seen to be whether or not the labor productivity had been raised, the production had been developed, and the people’s living had been improved. As a result, the increased outcome value in industry was remarkable.

**Table 4: Increased Outcome Value in Industry**

<b>Year</b>	<b>1980</b>	<b>1981</b>	<b>1982</b>	<b>1984</b>	<b>1985</b>
Outcome value	100	101	109.8	140.4	157.4

Source: GSO (1985)

In terms of import and export, in February 1980, the government released Resolution 40/CP to authorize the local units to exercise import and export. Thus, the state has officially recognized the previously-styled illegal right of the local institutions to this exclusive privilege. The result was remarkable with the strongly increased export turnover: 320 million USD in 1979; 338.6 million USD in 1980; 401.2 million USD in 1981; 526.6 million USD in 1982; 616.5 million USD in 1983; 649.6 million USD in 1984; and 698.5 million USD in 1985. Previously, the main external trading was through protocol execution among the socialist countries via 37 state general companies. Consequently, the export turnover was low, the average *per capita* of which was under 10 USD (MPI, 2008).

The changes in this respect were also marked with the total abolishment of the state subsidy. Therefore, a project of internal trade reform was designed to abolish all the subsidized prices of commodities which would be sold at the market prices with the compensation in cash for the government officers. As a result, 33 out of 42 subsidized commodities were abolished; the rest of 9 essential commodities, including rice, cloth, meat, sugar, fuel, etc... were remained under a ratio-based supply. Furthermore, on June 1<sup>st</sup> 1981, the government made a decision to give an allowance of 100 percent of the basic salary for the government officers.

### **3. Nation-wide renovation or *doi moi* and the market economy from 1986**

#### **3.1 Breakthroughs in the administration thinking**

The model of agricultural collectivization and industrial nationalization was the popular product of the bureaucratic centralism, which has existed for more than half of a

century in the socialist countries. The collapse of the Soviet bloc as well as the failure of the Stalinist socialist model adopted in the previous decades led to the search for a new development model. Post-war Vietnam's biggest challenge was to choose from numerous existing development models or come up with something else that was more appropriate for her and set her own pace to propel herself forward in this fast-changing world (Vu, 1994). The formation of the new model, first and foremost, started with the changes in thinking among the leading administrators.

“Looking at the truth and telling the truth” has become the slogan of the thinking changes, and seen as the most important breakthrough. For the first time, a truth to be looked at and told was that: the Party had made “serious and prolonged mistakes in terms of the great guidelines and policies for many years” (Truong, 1984: p.360). The mistakes included: “leftist deviation, puerility, voluntarism, counteraction of the natural laws...” and the shortcomings liked: “conservatism, sluggishness, and lack of bravery in correcting the committed mistakes” (Truong, 1984: p.270). Awareness of the mistakes and commitment to mistake correction has been regarded as striking evidences of changes in thinking.

The initial change in thinking also included the re-conceptualization of the transitional period. The pre-renewed thinking insisted in taking shortcuts and leaping from a small and backward production to a large-scale production by means of the public ownership and the highly central planning. What was previously seen as “creative” theoretical point, i.e. the possibility of bypassing the capitalist development to advancing quickly and vigorously to socialism, has been proved to be adventurous and utopian. The renewed thinking was stated that “bypassing the capitalist regime to advance directly to socialism is unrealizable” (Tran, 2002: p.15).

Concepts of development have been reviewed accordingly. Development was then perceived as a multi-dimensional process involving the reorganization and reorientation of the entire economic and social systems. A simple introduction of the market economy was never enough. Remnants of the former centrally-planned economy needed to be tackled by a massive reorientation of the public sectors. Poor management, inefficient practices and public criticism of public services have led to a strong commitment to structural adjustment program with appropriate modifications to best fit the real situation of Vietnam. The motto of developing a market economy in a general manner was replaced by the crucial and concrete policies of macroeconomic stabilization, fiscal discipline, price reforms, tax reforms, financial liberalization, trade liberalization, deregulation, private sector development, legal reforms, and institution building. From an economic standpoint, this meant cutting deficits, reducing government intervention in the economy and creating an environment favorable to growth, in which the private sector would play a certain role.

When the central planning collapsed, the role of state changed drastically. A transitional country like Vietnam has been in the midst of reconceptualizing the state, from that of a producer and controller to that of a supporter of private sector activities and a regulator of socio-economic activities. From the political and administrative standpoints, this meant establishing a minimum state apparatus by reducing bureaucracy and using public resources more effectively under the umbrella of a market economy (Israel, 1999). The state administration in this context became the object, and at the same time, the major agent of reform. It must be placed at the core of the change process, and must also change itself in order to perform its duties in the new environment (Wolf, 2000). The scope and speed of changes and the complexity of the environment have forced public agencies to adapt

themselves to better respond to the political, economic, social and technological changes, and massive societal changes as well. Although these reform efforts have gone under various labels, for example, either “reinventing government” (Osborne & Gaebler, 1992), or “new public management” (Barzlay, 2001), or “managerialism,” their ultimate goals have always implied the increase of efficiency, effectiveness, responsiveness and accountability of public management (Romzek, 2000). In the evolving paradigm, one cluster of principles has been comprised of the reversals of the traditional upper-lower relationships and the introductions of the new ones characterized by decentralization – delegating power from the central control downward to the periphery trust, democracy – getting away with authority dominance for dispersed equality, diversity – reducing standardization for further differentiation, and dynamism – terminating stabilization for continuous changes (Leonard, 1989).

The changes in thinking, including the renewal of conception and perception as above-said, have led to the changes in the development model design, the leadership modality, and the management style. First, it led to destruction of the development model of the “in-kind economy” that denied the commodity production, the market economy, and the law of values. Then, the model change would obviously lead to the changes in the management regime that was characterized by the centrally and absolutely planned mechanism. Such model and regime had naturally generated red-tapism, bureaucratism, imperativeness, and subsidy, thus leading to increased wastage, corruption and privileges. The renewed thinking has strongly promoted a definitive turning from the centrally-planned economy to the commodity economy under the market mechanism. It was argued that the market would long-lastingly exist even though one has tried to reject it at one’s will. The best way, therefore, was to acknowledge it, to make the best use of it, to limit the harms of it, to coexist with it, and to navigate it in the interest of the national development. Such thinking was stated: “It is natural that where there is the production of commodities, there is the market and market mechanism. We can not abstain from the market mechanism, as it is the operation of the natural law out of our subjective will” (Truong, 2007: p.65).

The renewed thinking has restored the dialectical relationships between the productive forces and the productive relations, which were completely ignored by the orthodox thinkers and administrators. Its justification was that a new mode of production had never been born without the correlative material conditions of the development level of the productive forces. A typical example of the incompatibility was the building of a large-scale production in the high-level cooperative system on the basis of the traditional productive tools, such as buffaloes and ploughs. The position argued here was that the collective agriculture model with large-scale production had serious problems, not only as a formula for development but also in terms of its socialist credentials, and that recent policy changes might open the way for a less statist and more democratic rural development (Watson, 1983). In the previous cooperative system, real democracy was actually absent. The agricultural producers’ cooperative contained all of the ambiguity of a democratic-centralist socialist institution. It incorporated aspects of both centralized state control (i.e. incorporation of cooperative production into the national plan; sale of produce to the state at prices fixed by the state) and formal economic and political democracy in the form of election and overview of the cooperative management committee by the General Assembly of cooperative members (White, 1988). In fact, collectivization was never fully operational. The economic importance of the household economy over the collectivization time meant that there was never a complete transformation from peasant to collective agriculture – the system worked, in effect, as a symbiosis of collective and household agriculture. The failure of the collectivization regime also meant that the new mode of production had never been born.

The idea of an “open economy” constituted another part of the renewed thinking. The theoretical proposition that “the foreign investment is a means of exploitation of the developed countries towards the developing countries” has been seriously reviewed. It has been then considered a necessity for the “take-off.” This was a turning-point in the thinking of administration which broke through the great taboos of the obsolete conceptions of socialism, planning, socialist ownership, and the discrimination against the non-socialist sectors and the market mechanism.

It is also implied that thinking of administration must be rooted from the populace and that a sound policy was to be measured by the people’s interests. The pre-renovation top-down thinking was far away from the people. Without awareness and participation in the formation process, they have naturally never become the beneficiaries of the administration thinking outcomes, i.e. policies.

These significant changes in thinking of administration have thus oriented towards the hereinafter-demonstrated suitable management policies.

### **3.2. The renovation-oriented economic management**

From those changes in administration thinking, the renewals of economic development guidelines and economic management policies have been correspondingly set forth.

**3.2.1. With regard to the private economy and the household economy:** the release of Decree 27/ND on the private economy and Decree 29/ND on the household economy by the Council of Ministers on March 9<sup>th</sup> 1987 has officially restored the private sector status in the national economic system. These policies’ enactment in practice has brought into full play the economic potentials that had been for many years inhibited in the socialist rigid economic model. The family economy has been legalized and encouraged. The households have become free from prohibition, checking, arrestment, and confiscation; rather they have been facilitated in registering their businesses. The private enterprises have been boomed out to greatly assist the heavily deficient economy. In the new legal and economic environment, these private economic entities have occupied the market, and brought about an increased GDP and an improved people’s living standard.

**3.2.2. With regard to agriculture:** the change in agricultural production mechanism to a partially de-collectivized product contract under the label “Contract 100” in 1981 was not as radical a change as it appeared, but in some ways regularized and developed an already existing phenomenon within the collective agriculture. The remedy to the shortcomings of halfway-reformed Contract 100 came with the emergence of Resolution 10, known as “Contract 10,” by the Party Politburo in April 1988, which officially denied the obsolete elements of the collectivized cooperative model and set forth the progressive elements of a new de-collectivized cooperative model. The reoriented objective was to encourage individual initiatives in the household economy. This was achieved by expanding the right to free circulation and exchange of farm products so as to promote agricultural production and a more dynamic rural development. The official adoption of this fully de-collectivized household contract system was the result of the economic reforms in pursuit of a market economy. The contract has stimulated the farmers, pushed ahead production, and lessened the shortcomings as well as the negative features of the cooperatives. It anticipated a new tendency of postwar development in the rural areas. De-collectivization has obviously become another approach of Neo-Liberalism that has run counter to statism and the central



planning mechanism, and has brought about remarkable changes in agricultural and rural development, as well as the societal changes in the market economy of Vietnam consequently.

Resolution 10, or Contract 10, stated that: i) cooperatives and production collectives are collective economic units with various types of ownership over the means of production; ii) this new conception of the cooperative is applied to all business organizations willingly founded and pooled by the laborers, and democratically managed, without discrimination of dimension, technical level, or rate of collectivization towards the means of production; iii) the member households are autonomous economic units (Truong, 1999). *As far as the ownership over the means of production is concerned*, Contract 10 conducted an important change which officially granted land to cooperative members for their usage, and practiced multiple ownership forms over the means of production. *As far as the management of production is concerned*, cooperative farmers were entitled to autonomy in agricultural production and other economic activities for their well-being. *As far as the distribution of produce is concerned*, cooperative members had just to pay taxes to the state; all production activities between the cooperative and members were transacted via the commodity-monetary relationship; and the workpoint-based distribution was abolished. The foundation and *raison d'être* of the collectivization model was broken down. Collectivization over the means of production was no longer the crucial criterion of the cooperatives. The forces of production therefore escaped from binding with the relations of production under the old mechanism (Vo, 1988). Resolution 10 also “recognized the prolonged existence and the positive impacts of the private individual economy in the advancement to socialism; acknowledged the legal entity, ensured the equality of obligation and right before the law, protected the legitimate business and legal incomes of the private individual households” (Complete Works of Party Documents, 2007: p. 96).

**3.2.3. With regard to the autonomy in business and production:** with Decision 217/HDBT on November 14<sup>th</sup> 1987, the autonomy in business and production was officially granted to the state enterprises, which read: “Enterprises have the rights to make and conduct the long-term, mid-term and short-term plans for their production and business operations.” Correspondingly, the number of the planned norms assigned by the state has been curtailed from hundreds to only two main norms, i.e. the total outcome value and the items of payment to the state budget. All of other norms were totally decided by the enterprises, including that of the human resources. In terms of the accounting, enterprises are required to exercise the socialist economic and business accounting, calculate properly and adequately the costs of production, discount the cost prices of products, deal with their own finance, and make profits on business. A trial of stocks selling and purchasing in selected enterprises has also been allowed in this text.

**3.2.4. With regard to the commodity circulation:** by the enactment of the government’s Decision 80/CT on March 11<sup>th</sup> 1987, all the commodities were freely circulated throughout the country. The Decision stipulated “to dissolve the check-points on the inner- and inter-provincial roads...” (Official Gazette, 1987: p.106). As a result, the producers managed to sell products at the market prices; the consumers managed to buy things at reasonable prices; there were no more long queues for purchase; there were no more black market “cut-throat” prices; the tension of the supply-demand relationships became released (Hoang, 2003). In retrospect, the prevailing thinking advocated the strict control. For example, rice was purchased in accordance to the size of the rice basket – the larger the basket, the more to be purchased. Another example is that people were blocked the way to have every sack of rice,

every chicken, every kilogram of sugar... searched. This measure of strict control caused circulation jam and increased the faked scarce of commodities.

**3.2.5. With regard to the distribution and compensation:** from 1989, the ratio-based distribution system was totally abolished after 3 years of partial abolishment. The relationships of distribution in kind have been changed to the commodity-monetary relationships. Under these relationships, all of the prices in the market have been adjusted according to the supply-demand relationships of the market.

With dismantling the old public sector wage structure, no longer would workers be paid mainly according to length of service, nor would they be guaranteed employment for life. A plan was announced to place all government workers on contracts (Hiebert, 1993; Norlund, 1993). The wages of public servants were gradually and partly monetized. Previously, only a fraction of salaries of the civil servants or state enterprise employees was paid in cash. Up to 90 percent were received in the form of bonuses and in-kind payments (ILO, 1994). Now state workers would no longer receive access to rationed goods at artificial prices and fringe benefits, such as subsidized housing, health services, education and social insurance (Moock et al., 1998).

**3.2.6. With regard to the price system:** the resolution of the Party's 2<sup>nd</sup> Central Executive meeting in April 1987 advocated "not to remain the prices of selling and purchasing as low as that at present, rather to step by step adjust them, without inducing any mutation towards other kinds of prices and any sudden increase of the currency in circulation" (Complete Works of Party Documents, 2007: p.64). It was affirmed that: "Apart from tax as the compulsory obligation of contribution, all of the exchange relationships between the farmers and the state economic organs, from now on, have to follow the principle of equality, at par, mutual interest, negotiation-based selling and purchasing" (Complete Works of Party Documents, 2007: p.63).

**Table 5: Rates of Price Adjustment of Selected Main Materials (as of quarter IV, 1987)**

Kinds of materials	Unit price	Rates of price		Rates of increase (times)
		Pre-adjustment	Post-adjustment	
Petrol A72-76	<i>dong/ton</i>	690	5,600	8.1
Coal	<i>dong /ton</i>	600	5,200	8.6
Electricity	<i>dong/KWh</i>	1,200	8,500	7.0
Cement	<i>dong /ton</i>	2,000	25,000	12.5
Wood	<i>dong /m<sup>3</sup></i>	1,300	15,000	11.5
Cotton fibre	<i>dong /ton</i>	29,600	220,000	7.4
Iron	<i>dong /ton</i>	4,830	33,800	6.9

Source: GSO (1988)

There appeared a great change in the purchase price policy of agricultural products. As stated by Vo Van Kiet, the then Deputy Chairman of the Council of Ministers, on March 18<sup>th</sup> 1987: “From now on, it is imperative to negotiate the prices with the farmers in the purchasing contracts; and cash must be paid instead of kind.” Upon September 1987, the purchase prices of the agricultural products were increasingly adjusted by 10 times compared with those of September 1985. In terms of the animal husbandry products, the prices increased 33 times compared with those of quarter III 1985 (Phan, 1992).

**Table 6: Changes in Purchase Prices of Rice in Different Regions**

<b>Agricultural products</b>	<b>1985 price (dong/kg)</b>	<b>1987 price (dong/kg)</b>	<b>Rate of increase (times)</b>
<b>Ordinary rice</b>			
In Northern Delta	2.5	31.0	12.4
In Central Delta	2.2	28.0	12.7
In Mekong River Delta	1.75	25.0	14.2
Groundnut with shell	6.0-8.0	75.0-93.0	11.6
Dried tobacco	21.0-26.0	341-403	15.0
Tea	3.5-4.0	42-46	11.5
Coffee	30-32	364-403	12.5
Sugar cane	0.23-0.40	5.0-6.2	15.5
Rush	2.7-3.0	31-34	11.0
Jute	7.0-7.5	84-93	12.4
Aniseed	8.0-10	108	10.8

Source: GSO (1988)

**3.2.7. With regard to the property rights:** in order strongly to embark upon agricultural de-collectivization, it is imperative to renew the Land Law to make up a legal foundation for the peasants’ property rights to land. The property rights reform is indeed guiding the former planned economy towards market incentives. Since the Vietnamese economy is basically agrarian, the establishment of a multi-sector market economy depends to a great extent on the solution of the ownership issue in agriculture, primarily the issue of land ownership (Makarov, 1991). The 1993 Land Law passed by the National Assembly formalized and rationalized this process already underway by acknowledging the right to sell or lease land, mortgage or inherit land use rights, and receive compensation for transfers based on the market prices. Land is the property of the entire people and placed under the management of the state, which hands it over to peasant households for stable and long-term use, the tenure of which is 20 years for the annual crops and 50 years for the perennials (Vu, 1994; LAB, 1994; Truong, 1999; Tran, 2001; Nguyen, 2003). When the fixed time limit is reached, users that need to use land for plantation purposes will be entitled to continue using the land entrusted to their management for a further period of time (Vu et al., 2000; Lam, 2002). Peasants therefore become actual owners of the given land for a certain time, not only users of the land. The right to long-term land use thus creates a stable foundation for the autonomous economy of peasant households. In order to create favorable conditions for peasant households to properly manage the allotted land, the users are given state certificates for land rights. With these certificates, the households have the right to legally rent, transfer,

exchange, or mortgage the land for financial purposes. Additionally, land certificates are accepted as collateral (Ravallion & Van de Walle, 2003).

**3.2.8. With regard to the interest rates:** with Decision 55/CT on March 10<sup>th</sup> 1989 by the Council of Ministers, the interest rates of savings had been increased closer to the market's interest rates. Previously, there existed a nonsense phenomenon of the interest rates of saving and lending being much lower than the rates of the price slippages. It was ironically said: "if you deposit a chicken, you will withdraw an egg." Various methods of administrative coercions were therefore practiced to mobilize the savings from the populace, such as: a portion of the government officers' monthly salaries was extracted for a bank saving or government bonds. In times of the soared inflation rate at hundreds of percent, with the preferential interest rate at zero or symbolically from 1 to 2.5 percent *per annum*, the state enterprises just needed to purchase the raw materials to reserve. By this way, they could make a huge "profit" as many times of the borrowed sum, without doing any production or any business.

With Decision 39/HDBT on April 10<sup>th</sup> 1989 by the Council of Ministers and Decision 73/NH-QD on May 31<sup>st</sup> 1989 by the Governor of the State Bank, the interest rates of lending were readjusted in accordance to the rates of the price slippages. On June 13<sup>th</sup> 1989, the Governor of the State Bank issued Decision 29/NH-QD that increased the interest rate of the current accounts to 9 percent per month and that of three-month term to 12 percent per month (previously from 1.8 to 2 percent per month), which would be further readjusted in accordance to the fluctuation of the inflation rates. With these "positive interest rates," the bank savings have been increased strongly. As a result, by the end of 1989, a sum of 1,900 billion *dong* was deposited in the banking system to be invested in production.

As the result of the interest rate reforms, the inflation pressure has also been greatly released (Official Gazette, 1989). In 1989, the national economy has got important achievements with the remarkable success of controlling and checking a serious and prolonged inflation, and greatly reducing the monthly increased rates of prices from 14.2 percent in 1988 to 2.8 percent in 1989 (Dang, 2008).

**3.2.9. With regard to the exchange rates and import-export:** the exchange rates at the domestic market were increased closer to those at the international market. Previously, the exchange rates of the imported goods were calculated very low which was far away from the real value of the local currency, thus the imported industrial and agricultural materials were sold at very low prices. This was the typical outcome of the subsidized and bureaucratic regime that failed to reflex the real prices of the imported materials and exported goods. These two kinds of the state-stipulated prices were greatly different from those in the internal and international markets. These exchange rates distorted all economic relationships and economic calculations. Therefore, it was indistinguishable whether the state enterprises got a loss or a profit. As a matter of fact, the state lost billions of dollars by these "real losses and faked profits". Finally, these exchange rates were officially abolished since March 1989 which has greatly facilitated the demolition of the subsidized and bureaucratic regime, and at the same time, forced the state enterprises to practice proper accounting.

In 1989, the Council of Ministers allowed the South Food Company to export rice as a trial that put an end to the interminable import and the chronic shortage of rice. As a result, the export turnover has doubled compared to the previous year, which accounted approximately 2 billion USD. The balance of payment deficit decreased from 1.7 billion USD in 1988 to 600 million USD in 1989 (GSO, 1994). The remarkable result was that from a

country being chronically short of food, Vietnam has become the third then the second largest rice exporter in the world.

**3.2.10. With regard to the foreign investment:** in accordance to the thinking of an “open economy,” the Law on Foreign Investment on December 29<sup>th</sup> 1987 officially permitted the foreign capitalist investment in Vietnam. This has opened a door to various abundant sources of capital, technology, intelligence, and markets. This has also made a full stop to the discrimination towards the capitalist economy. Since then, the increased FDI has greatly contributed to the economic growth of Vietnam.

**Table 7: Number of FDI Projects in Vietnam**

	<b>1988</b>	<b>1989</b>
Number of projects nationwide	37	68
The registered capital in total (mil. USD)	371.8	582.5

Source: GSO (1999)

### **3.3. The renovation-oriented political initiative**

In addition to a radical modification of the pre-existing economic model, Vietnam’s renovation has also entailed a gradual process of institutional adaptation without altering the core components of the political system. The introduction of liberal market economy principles since the late 1980s has co-existed with both a Marxist single-party institutional architecture and an ideological corpus envisioning socialist democracy. Both these approaches point to the integration of state and society, which in the Vietnamese context is viewed as resting on four main principles: the leading role of the party, the socio-political functions of mass organizations, the concept of collective mastery, and the exercise of democratic centralism. The institutional adaptation process has been driven by both societal demands triggered by the new economic order and legal changes undertaken by the Vietnamese leadership. This process is, ultimately, modifying the framework of relationships between rulers and citizens via the grassroots democracy model. The grassroots democracy model originates from the widespread anti-corruption protest and disturbance in Thai Binh province in 1997. As a result, in 1998, the party embarked on an attempt to carry out political reform through the establishment of the Decree 79, known as *Grassroots Democracy Decree* (GDD), which “approved the participation of community-based organizations in development activities at the commune level” (Thayer, 2009: p.4). The party also issued Directive 30/CT establishing the policy basis for strengthening the participation of communities at the local level. Decree 29/1998/ND-CP then, aimed to improve the transparency and accountability of local government, and stipulates that information is disseminated to citizens who would then be well-informed enough to participate in discussion, decision and monitoring of local government. The GDD endows people with substantial capacity to influence the local decision-making process on various issues, and aims to enable popular participation in commune public affairs by enforcing mechanisms relating to “affairs to be communicated to the people; affairs to be discussed and directly decided by the people; affairs to be discussed or commented by the people and decided by commune administration; and affairs to be supervised and inspected by the people” (<http://www.Decree-No-29-1998-ND-CP>).

Regardless of the outcomes of its implementation, the GDD was a political initiative of paramount importance – an issue that goes beyond a mere reform of public administration,

as it may potentially affect the very sources of legitimacy of the entire institutional system. This is a political measure highly consistent with the existing legal and political frameworks, particularly in regard to core theoretical principles such as collective mastery, democratic centralism and socialist democracy. However, it is obviously insufficient, because their regulations are highly limited in terms of implementation mechanisms; given that, the modes of citizen involvement are mostly the exchange of notes, indirect participation through state agencies, and meetings of the People's Council. Consensus, rather than pluralism and potential confrontation, is the guiding principle of political decision-making. Given, however, that the economic reforms are bringing social and economic plurality, the challenge for the party is to identify the right mechanisms to incorporate the new socio-economic actors into the consensus-building arrangements. In fact, the attempts of the party to combine market economy with political unity may only bring partially plausible initiatives such as the GDD, but will not bring real and thorough political renewal. Hence, the Vietnamese concept of grassroots democracy "is meant more as a 'social value' or methodology of governance than as a political system" (Wells-Dang, 2010: p.107). However, through this development process of democracy, Vietnam is consciously learning and applying "theories and practices from developed countries and management experience of Western law-based states where democracy has a centuries-old history, tradition and culture" (Wells-Dang, 2010: p.107).

## CONCLUSION

Vietnam in the past had gone through a painful period under the French colonialism in the north and the American imperialism in the south. Therefore, the orthodox ideals of socialism – economic growth, social justice and equality, the provision of public welfare and job security – broadly attracted her citizens. Economic development has thus been oriented towards these ideals.

It is, nevertheless, in the postwar Vietnam that such long-standing orthodox thinking has been broken through, out-of-date paradigms of development have been renewed, new models and laws have been adopted, reform-oriented initiatives have been experimented, transitional policies have been shifted in the right direction, market institutions have been created, new skills and behaviors have been introduced, and better and greater achievements have been obtained. But the path to development is to be measured over the period of generations, and the goal of development is still far ahead. The newly-emerged market economy of a transitional country like Vietnam, with so many institutional deficiencies, still must cope with the great challenges of a combination of the need for change with the need for continuity and order. But seen through a critical lens, the conclusive idea is that these transitional challenges are creating opportunities for Vietnam to create a learning-by-doing trial for her betterment, and also to reconfirm her strong commitment to the continuous renovation.

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# **THE SAVING AND LOAN COOPERATIVES MODEL IN INDONESIA**

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## **ABSTRACT**

Cooperatives have played a significant role especially for the poor people in the Micro, Small, and Medium sized Enterprises (MSMEs). Saving and Loan cooperatives in Indonesia have been in existence since the Dutch colonization in the 19<sup>th</sup> century to provide alternative financial services for the poor and needy people to help themselves. The purpose of this study is to (1) describe the current practices of saving and loan cooperatives in Indonesia (2) review the patterns and the common themes in the current practices to classify them into several business models; (3) make the list of the participants and stakeholders related to saving and loan cooperatives in Indonesia; (4) map the positioning of saving and loan cooperatives in the landscape of microfinance institutions in Indonesia. Seven business saving and loan cooperative models are highlighted in this study, namely – Credit Union, Quasi Credit Union, Quasi Bank, Joint Liability (Group Lending), Sharia-based Cooperative, Saving and Loan Unit, and Partnership. This study applied comprehensive methodology approaches including case studies (qualitative method) and surveys (quantitative method). All the seven featured cooperatives have developed some type of supervision and reporting procedures. In general, policy making is done through Annual Members Meeting (RAT) with a representation system, while operational decisions are made by operational staff in consultation with Management Board, and Supervisory Board. The study found that all the seven cooperatives promote transparency and accountability in their profit sharing policies.

**Keywords:** Credit Union, Quasi Credit Union, Quasi Bank, Joint Liability (Group Lending), Sharia-based Cooperative, Saving and Loan Unit, Partnership, Micro, Small and Medium Enterprises (MSMEs). Annual Members Meeting (RAT)

# THE SAVING AND LOAN COOPERATIVES MODEL IN INDONESIA

## 1. INTRODUCTION

Strengthening as well as empowering the Saving and Loan Cooperative Sector in order to increase financial accessibility for Micro, Small, Medium Enterprises (MSMEs) is an important development agenda in Indonesia. The MSMEs have a strategic role in economic development in Indonesia, including contribution to country's economic growth, employment creation and the distribution of the economic development results. The statistic shows that at the end of 2009 there were 52.7 million Micro-SMEs which represented 99.9% of total enterprises in Indonesia. These Micro-SMEs also provided 97.3% of total employment in the economy and accounted to 56.5% of Indonesia's GDP in 2009.

To maintain and foster business growth, the MSMEs need to continue and provide adequate access to source of credits. Numerous studies, surveys and Government experience have indicated that access to finance<sup>1</sup> is one major hindrance for MSMEs to grow and expand their businesses as such that a substantial number of MSMEs still do not have access to credits from the commercial banks<sup>2</sup>. The limited outreach of the banking services, lack of bankable collateral and poor information in hands to assess potential borrowers' creditworthiness and business risk are widely cited as the main reasons for the lack or inadequate access to commercial banks' credit for the MSMEs.

Indonesia is known to have a large and vibrant microfinance sector with more than 100,000 of Micro Finance Institutions (MFIs) that are closely associated with rural economy activities. These MFIs have been playing an important role in providing basic financial services to millions of individuals and business enterprises in Indonesia for decades. The majority of borrowers of MFIs are Micro-SMEs.

As a one of MFIs, Saving & Loan Cooperatives have a strong foothold in the Indonesian economy. The legal framework for the saving and loan activities of cooperatives<sup>3</sup> was based on the Government Regulation (GR) No. 9 in 1995 that is further elaborated by the Ministerial Decree No.351 in 1998. The GR No. 9/1995 stipulated the saving and loans activities may only be carried out by (i) a single purpose cooperative which is better known as the Koperasi Simpan Pinjam (KSP)/*Saving and Loan Cooperative* and (ii) a saving and loan unit within a multipurpose cooperative which is better known as the Unit Simpan Pinjam (USP)/*Saving and Loan Unit*.

The KSP and USP have the ability to reach out and offer their financial services to a large number of population in Indonesia through articles in the GR which allow the KSP/USP to (i) service their members, member candidates, other cooperatives and their members and (ii) open branch or outlets in other areas of its primary location without much restriction.

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<sup>1</sup> For most people including policy makers, the term "access to finance" is used interchangeably with "access to credit" although the term "access to finance" ideally should include access to saving products also.

<sup>2</sup> Bank Indonesia and Ministry of Cooperative & SMEs indicated that only 50 percent of SMEs have access to banking sector. A nation-wide household survey on access to financial services in Indonesia conducted by the World Bank in 2009 shows that only 49 percent of the population has access to the formal banking sector.

<sup>3</sup> The saving and loan cooperative sometimes is also referred to as the financial cooperative or credit cooperative.

This study will provide the general overview about saving and loan cooperatives in Indonesia to serve as a background analysis on how they can play their role in the development of MSMEs (Micro, Small, and Medium Enterprises).

It is expected that the discussion will lead to a better understanding on how saving and loan cooperatives in Indonesia can be further developed and empowered in their service to MSME clients. Special emphasis will be given to how the government can support loan and saving cooperatives through the regulations. This report is made on the assumption that saving and loan cooperatives can provide wider coverage to MSME clients than other types of financial institutions. The goal of the study is to come up with policy recommendations to the government as to how the regulations can help saving and loan cooperatives in strengthening their outreach to MSME clients.

The case studies are expected to provide an illustration of the different business models of saving and loan cooperatives in Indonesia.

## 2. METHODOLOGY

This diagnostic study on the saving and loan cooperative in Indonesia will use comprehensive approach. Therefore, a combination of qualitative and quantitative methods will be used to conduct this study.

**A detail literature review** will be conducted to get an overview of saving and loan cooperative in Indonesia, including history and development, type/characteristic, existing structured and working mechanism, the role of involved stakeholder, related regulation, as well as supporting facilities. It also expected will provide general picture of weaknesses and challenges which is faced by saving and loan cooperatives and the opportunities to develop it in the future.

**Qualitative Method** will be used to get data and information both in central and local level. *Semi Structured Interview* to some key stakeholders will be conduct in central level, consist of Central Government (Ministry of Cooperatives and SMEs, Bappenas), National Level Cooperatives which are coordinating each type of secondary cooperatives (e.g. national cooperative for credit union/Inkopdit), Agency that supporting the cooperative sector (Permodalan Nasional Madani/PNM, Revolving Fund Management Agency/LPDB), related NGOs (e.g. The Microfinance Innovation Center for Resources and Alternatives/MICRA). The result of interview will complementing with a detail literature reviews to get general picture of current conditions regarding opportunities, weaknesses and challenges faced by saving and loan cooperatives; and also to get development policy directions in the future from the central government. *Case Study* will be held in 5 different types of saving and loan cooperatives comprise with KSPs, USPs, Sharia based saving and loan cooperatives (BMT/KJKS), Credit Union, and Swamitra (a business entity resulting from a partnership between Bank Bukopin and cooperative providing saving and loan services). Success story or best practices of those chosen cooperatives will be expected become a lesson learned and as a considerance to strengthen the others.

**Quantitative Method**, the survey, will be held in some provinces which was having the top five quantity numbers of KSPs and USPs<sup>4</sup>. The survey will be consisted of some saving and loan cooperatives and its borrowers as a respondent. In each provinces will be picked of 20 KSPs according to some criterias such as variation types, size (related to omzet, asset and member quantity), and location (rural vs urban). In the other hand, 4 MSEs borrower of each KSPs/USPs will also be chosen according to some criterias, such as enterprises size (micro/small), and repayment status (smooth/stagnan).

The purpose of this study to:

- Describe the current practices of saving and loan cooperatives in Indonesia
- Review the patterns and the common themes in the current practices to classify them into several business models
- Make the list of the participants and stakeholders related to saving and loan cooperatives in Indonesia
- Map the positioning of saving and loan cooperatives in the landscape of microfinance institutions in Indonesia

In the end, the result of each method will be analyze comprehensively to get some conclusions and policy recommendations in strengthening and empowering the saving and loan cooperative sector in Indonesia.

### **3. BRIEF HISTORY AND DEVELOPMENT OF SAVING AND LOAN COOPERATIVES IN INDONESIA**

The initial formation of cooperatives in Indonesia can be traced back to the 19<sup>th</sup> century during the Dutch colonization in Indonesia. Since its first inception, cooperatives have been associated with grass root movements, representing the power of “people” with its philosophy of “by and for the people”. Cooperatives are founded by a group of people who share the same interests, fight for the same dreams (usually for economic welfares), and aimed for the benefits of its members. The groups usually represent community groups, such as farmer groups, workers, as well as groups with religious affiliations. During the Dutch and Japan’s imperialism, cooperatives had been feared for their power against the authority. As the nation gained independence in 1945, cooperatives have been playing an important role in promoting economic growth. Cooperatives have become the backbone of the nation’s economy as declared in the 1945 Constitution and the current government of the 21<sup>st</sup> century has shown their intention to reclaim the power of cooperatives.

As defined by the Cooperative Law no. 25/1992, types of cooperatives are determined by the shared needs, interests, and activities. The Ministry of Cooperatives then elaborates the types of cooperatives as:

- Producer cooperative
- Consumer cooperative
- Saving and loan cooperative
- Marketing cooperative
- Services cooperative

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<sup>4</sup> According to Ministry Cooperatives & SMEs data on 2009.

In Indonesia, saving and loan cooperatives constitute the largest percentage among all the types of cooperatives. Saving and loan cooperatives are further regulated through Government Regulation no. 9/1995, with implementation guidelines issued by Ministry of Cooperatives through Ministerial Decrees no 351/Kep/M/XII/1998 and no 194/Kep/M/IX/1998. Therefore, cooperatives in Indonesia are regulated and supervised for the compliance by the Ministry of Cooperatives.

Structure of a cooperative, as defined by the Regulations, involves:

- Founders
- Supervisory Board
- Management Board
- Members (as represented during the Annual Members Meeting or RAT)
- Clients (members and other parties that receive the cooperative's services)

Founders are the people who initiate and form the cooperative. As the cooperative grows, the number of constituents or members grows as well. With its togetherness philosophy, the highest authority lies in the hands of members (RAT), which will appoint Supervisory Board and Management Board to run and supervise the daily operations of the cooperative. In managing the daily operations, Supervisory Board and Management Board then have the authority to appoint operational staff.

Saving and loan cooperatives constitute the largest percentage of cooperatives in Indonesia, and the trend remains so since the very beginning. For instance, during the Dutch colonization, of the 574 existing cooperatives, 423 of them, or 77%, were saving and loan cooperatives. In 2012, of the 129,321 existing cooperatives, 70% of them were saving and loan cooperatives. Saving and loan cooperatives in Indonesia take forms in saving and loan cooperatives (KSP), Cooperatives for Sharia Financial Services (KJKS), and cooperatives' saving and loan units (USP). Based on data from the Ministry of Cooperatives 2012, saving and loan cooperatives in Indonesia have served over 18 million member clients, and the number could be significantly greater when non-member clients were included. The previous figures show the higher demand for KSP services, whether for the member or the non-member clients. Demand is more concentrated on the loan side, especially when clients have problems securing loans from the commercial banks.

Nevertheless, challenges remain for the fully functioning of KSP, among others:

- Some KSPs have not exercised the basic philosophy of cooperatives such as the social mission of helping the poor and for the welfare of the people
- Some KSPs serve non-member clients without requiring them to be members, defying the principle of "for the benefit of members"
- Many branches or servicing offices, supposed to expand the outreach, are set up in places with no members
- Minimum competence of the human resources that the organizations are run with limited technical expertise, lack of entrepreneurial spirit, and poor management

The Law No 17/2012 replace the current Law No 25/1992 but then cancelled by the Constitutional Court (MK) due to perceived misfit to the original concept of cooperative, was aimed to provide guidance for a better governance of cooperatives. As a new law is yet to taken place, there is some room for improvements as to how the government can help cooperatives in their governance through the regulations.

#### 4. POSITIONING OF SAVING AND LOAN COOPERATIVES IN THE DOMAIN OF MICROFINANCE INSTITUTIONS IN INDONESIA

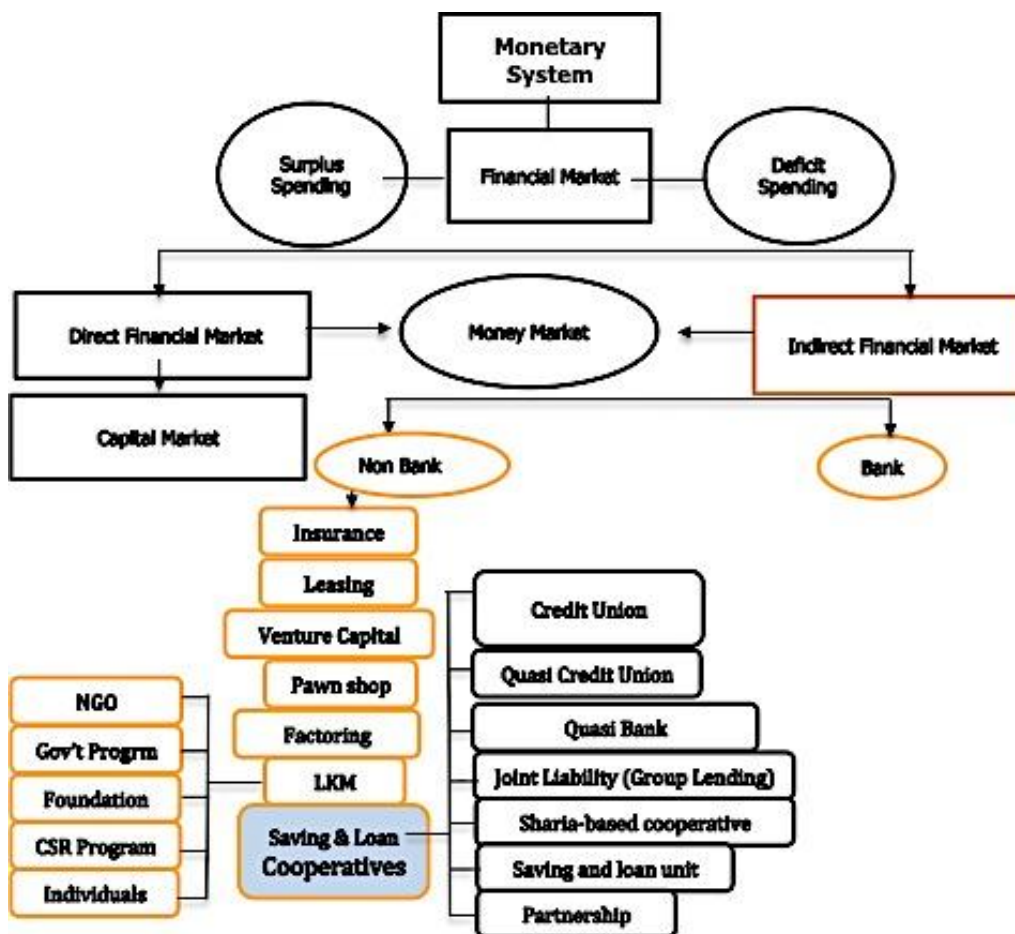
In general, the term Microfinance Institutions in Indonesia refers to various types of financial institutions. The term of microfinance refers to the loan size, which is much smaller than those offered by commercial banks. In Indonesia, microfinance or micro credit refers to loan size of Rp 50 million or below. However, many the microfinance institutions offer loans of much smaller size. Many only offer loans of around Rp 1-2 million up to Rp 5 million, while some offer even lower amounts.

Financial institutions that offer micro credits include, among others:

- Micro credit divisions of commercial banks
- Commercial banks that focus on micro credits, for instance: BRI and BTPN
- Rural banks
- Cooperatives
- Lembaga Keuangan Mikro (LKM, a term that refers to a specific type of microfinance institution)

Some government programs also offer micro credits such PNPM Mandiri.

The importance of microfinance institutions can be seen from their role in reaching out to the poor, those beyond the reach of commercial banks. A World Bank study in 2009 shows that only 49% of the population in Indonesia has access to commercial bank services while only 19% of poor households uses bank services. The position of saving and loan cooperatives in respective to other financial institutions can be seen in the chart below.



## 5. UNDERSTANDING BUSINESS MODELS OF SAVING AND LOAN COOPERATIVES IN INDONESIA

Based on literature reviews and interviews with a number of resources, the World Bank's study team has come up with seven business models for saving and loan cooperatives in Indonesia. The business models consist of:

1. Credit Union
2. Quasi Credit Union
3. Quasi Bank
4. Joint Liability (Group Lending)
5. Sharia-based Cooperative
6. Saving and Loan Unit
7. Partnership

The differences can be made based on their business orientations, membership status, funding sources and allocation, funders and loan disbursements, types of financial service, risk management practices, benefits for members, and governance. Examples of each model are represented by the seven selected cooperatives (KSP/USP) with their business model illustrated in the table below:

**Table 5.1: Examples of Saving and Loan Cooperatives Different Business Models**

No	Business Model	Name of KSP/USP	Description
1.	Quasi Credit Union	Ba'lota, Toraja	<ul style="list-style-type: none"> <li>▪ Saving and loan cooperative that sticks to the original concept of cooperative</li> <li>▪ Operates at national level and one the 10 best cooperatives in Indonesia</li> </ul>
2.	Quasi Bank	Kospin Jasa, Pekalongan	<ul style="list-style-type: none"> <li>▪ Saving and loan cooperative that operates like a bank</li> <li>▪ Operates at national level and the largest cooperative in Indonesia</li> </ul>
3.	Credit Union	CU Pancur Kasih, Pontianak	<ul style="list-style-type: none"> <li>▪ Saving and loan cooperative that adopts Credit Union principles, the oldest and the third largest Credit Union in West Kalimantan</li> <li>▪ Operates at provincial level</li> </ul>
4.	Sharia-based Cooperative	BMT Tamziz, Wonosobo	<ul style="list-style-type: none"> <li>▪ Saving and loan cooperative that adopts Sharia principles</li> <li>▪ Operates at national level</li> </ul>
5.	Joint Liability (Group Lending)	Komida, Jakarta	<ul style="list-style-type: none"> <li>▪ Saving and loan unit of a cooperative that adopts group lending to poor women</li> <li>▪ A unit of cooperative that operates at district/city level</li> </ul>
6.	Saving and Loan Unit	Rukun Makmur, Madiun	<ul style="list-style-type: none"> <li>▪ A saving and loan unit of a surviving village unit cooperative (KUD)</li> <li>▪ A unit of cooperative that operates at district/city level</li> </ul>
7.	Partnership	Swamitra Cipulir, Jakarta	<ul style="list-style-type: none"> <li>▪ A saving and loan unit of a traditional market cooperative (Koppas) Cipulir, adopting a foster parent system of Bukopin.</li> <li>▪ Operates at district/city level</li> </ul>



The different business models emerge from the possibility of serving member as well as non-member clients, thanks to the current regulations – Law no 25/1992 and Presidential Regulation no 9/1995 – that allow cooperatives to have such options. Most Saving and Loan Cooperatives evolve and find their own path through the dynamics created by their founders and management team in response to government regulations as well as business competition. While some thrive, some are near collapse, therefore, it will be inconclusive to say if one business model is better than the others.

### **Business orientation**

There have been ongoing debates with regard to the purpose of cooperatives. The original concept of a cooperative<sup>5</sup> is to serve as a media for people to work together for common economic purposes and for the benefits of the people. In the process, inclination for profit lets business motives rule the organization and put less priority on the benefits of the people. Indonesian Constitution of 1945 has put cooperatives as the backbone of the nation's economy, which is based on the philosophy of "by the people and for the people". The International Labor Organization (ILO) defines a cooperative<sup>6</sup> as an "*autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise*". The existing Law of Cooperative no. 25/1992 defines a cooperative as a business entity formed by individuals or a cooperative legal entity that operate under cooperative principles. Hence, a cooperative signifies a people movement, in which common goals and togetherness serves a base. Members become the owners and the clients at the same time, they are the actors as well as the target recipients, and their well-being becomes the main goal.

However, the shift of focus from the people to financial gain may occur when competition creates pressure to the cooperative. The need to raise more money to improve and expand their services leads to the cooperative expanding reach to non-member clients, in which it acts more like a bank. Furthermore, the limited supervision from the current authority of the Ministry of Cooperatives put cooperatives in the loose end that they can either put members' interests or financial gain as their main goal. Cooperatives are regulated and supervised by the Ministry of Cooperatives, which are yet to find more effective control measures. From the regulation standpoint, cooperatives are more lenient compared with other financial institutions. Banks, for instance, are under close supervision and strict regulations by the Central Bank (Bank Indonesia), and now the Financial Services Authority (OJK). The relative laxity in regulations governing cooperatives creates loopholes that can easily be misinterpreted.

In relation to the seven business models represented by the sampled cooperatives, the survey shows that their business orientations vary accordingly with the classification can be seen in the table below. The classification is made based on, among others, the allocation of profit for the benefits of the members. KSP Balo'ta, for instance, in 2011 allocates 17.2% of its profit for education and Annual Member Meeting (RAT) related expenses, a higher percentage than average.

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<sup>5</sup> The cooperative movement began in Europe in the 19<sup>th</sup> century as part of labor and social movements during the Industrial Revolution. For saving and loan cooperatives, the credit union movement was initiated in Germany by Raiffeisen as part of social movement to promote unity among peasants. The concept of Credit Union is to empower the poor to help themselves by working together for the welfare of the community.

<sup>6</sup> See [www.ilo.org](http://www.ilo.org) for their work with cooperatives.

**Table 5.2: Business Orientation of selected Saving and Loan Cooperatives**

Names of Saving and Loan Cooperatives (KSP-USP)	Business Orientation	
	The benefits of the Members (Empowerment)	Financial Gain (Profit)
CU Pancur Kasih	√	
KSP Balo'ta	√	
Kospin Jasa		√
BMT Tamzis	√	
Koperasi Mitra Dhuafa	√	
USP KUD Rukun Makmur		√
USP Swamitra Koppas Cipulir		√

How each of the cooperatives set their priorities in terms of members (empowerment) or financial performance (profit) are explored in detail in the World Bank's study on "The Different Business Models of Saving and Loan Cooperatives in Indonesia" mentioned earlier. Meanwhile, study on "Saving and Loan Cooperatives' Management Board",<sup>7</sup> also conducted by the World Bank to 133 saving and loan cooperatives early this year, found the estimated profit allocation for education at 7% in average.

### **Membership Schemes**

Referring to the original concept of cooperative, in which a cooperative is formed by the people and for the people, the people are represented by the members. Members are the constituents. Therefore, the membership status should define the meaning of a cooperative. However, the Law no. 25/1992 allows privilege membership, which can deviate from regular membership. With privilege membership the people are entitled with their own rights and obligations that can be stipulated in their article of association. The Government Regulation No. 9/1995 allows saving and loan cooperatives to serve non-member clients, defined as those who are yet to be members. Nevertheless, the regulation stipulates that the non-member clients should become members within three months, asserting that membership is compulsory.

In this World Bank study, membership is associated with four criteria:

- Contribution through primary saving and compulsory saving
- Entitlement for dividend (SHU)
- Registration and attendance to the Annual Membership Meeting (RAT)
- The right to vote and to be nominated

Semi membership system is applied by some cooperatives whose clients do not meet the four full membership criteria. Using the seven business models to illustrate the membership schemes, we can see how the seven cooperatives differ in terms of their membership schemes.

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<sup>7</sup> This survey was conducted to gain the picture of the supply side, which is from the cooperative management point of view. Additional survey is to be conducted to gain the clients' point of view, to understand the demand side. Results of both surveys, plus results of Survey on Business Models, constitute the parts of this report.

**Table 5.3: Membership Schemes**

Name of saving and loan cooperative	Semi Membership	Full Membership	Privilege Membership
KSP Balo'ta (Quasi Credit Union)	<p>Clients with semi membership make up a small percentage of total clients.</p> <p><b>Requirements:</b></p> <ul style="list-style-type: none"> <li>- Open to Indonesian citizen with legal capacity</li> </ul> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Those who haven't paid the primary and compulsory saving in full and haven't passed the selection process for membership.</li> </ul>	<p>Full memberships constitute the majority of clients.</p> <p><b>Requirements:</b></p> <ul style="list-style-type: none"> <li>- Pass the selection process conducted by the cooperative Management Board</li> <li>- Will comply with KSP Balo'ta's Article of Association (AD/ART)</li> <li>- Pay for primary saving and compulsory saving in full</li> </ul> <p><b>Membership entitlements:</b></p> <ul style="list-style-type: none"> <li>- Voting rights during RAT</li> <li>-The right to be nominated and to vote for cooperative's Management Board and Supervisory Board</li> <li>- Entitled to receive dividend (SHU)</li> <li>- Full service from the cooperative, which include saving, loan, and security fund</li> <li>- Participation in the activities and supervision of the cooperative</li> </ul>	<p>Privilege memberships constitute a small percentage of total clients.</p> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Students from preliminary to high school, who use saving products</li> <li>- Members who live beyond the operational jurisdiction of the cooperative</li> <li>- Foreign citizens who want to open saving accounts at the cooperative</li> </ul> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- The use of saving products</li> <li>- No voting rights and no nomination for Management Board or Supervisory Board</li> </ul>
CU Pancur Kasih (Credit Union)	<p>Semi membership makes up a small percentage of total clients.</p> <p><b>Requirements:</b></p> <ul style="list-style-type: none"> <li>- Open to Indonesian citizen with legal capacity</li> </ul> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Those who haven't paid the primary and compulsory saving in full</li> <li>- Those who haven't</li> </ul>	<p>Full memberships constitute the majority of clients.</p> <p><b>Requirements:</b></p> <ul style="list-style-type: none"> <li>- Enrolled in the initiation training level 1</li> <li>- Pay for primary saving and compulsory saving in full</li> <li>- Comply with AD/ART and CU principles</li> </ul> <p><b>Membership entitlements:</b></p>	<p>Privilege memberships constitute a small percentage of total clients.</p> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Students who use saving products</li> <li>- Members who live beyond the operational jurisdiction of the cooperative</li> </ul>

Name of saving and loan cooperative	Semi Membership	Full Membership	Privilege Membership
	enrolled in the initiation training level 1	<ul style="list-style-type: none"> <li>- Voting rights during RAT</li> <li>- The right to be nominated and to vote for cooperative's Management Board and Supervisory Board</li> <li>- Entitled to receive dividend (SHU)</li> <li>- Full service from the cooperative, which include saving, loan, and security fund</li> </ul>	
Komida (Joint Liability, Group Lending)	<p>Semi membership makes up a small percentage of total clients.</p> <p><b>Requirements:</b></p> <ul style="list-style-type: none"> <li>- Poor women who plan to or already have micro businesses</li> <li>- Willing to be part of a group for a joint liability</li> </ul> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Those who haven't paid the primary and compulsory saving in full</li> <li>- Those who are still in the group training process</li> </ul>	<p>Full memberships constitute the majority of clients.</p> <p><b>Requirement:</b></p> <ul style="list-style-type: none"> <li>- Pay for primary saving and compulsory saving in full</li> </ul> <p><b>Membership entitlement:</b></p> <ul style="list-style-type: none"> <li>- Participation in RAT<sup>8</sup></li> </ul>	
BMT Tamzis (Sharia based)	<p>Semi membership makes up a small percentage of total clients.</p> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- Limited access to financing services</li> <li>- No involvement in RAT</li> </ul>	<p>Full membership makes up a small percentage of total clients.</p> <p><b>Requirement:</b></p> <ul style="list-style-type: none"> <li>- Pay for primary saving and compulsory saving in full</li> </ul> <p><b>Membership entitlement:</b></p> <ul style="list-style-type: none"> <li>- Participation and voting rights during RAT</li> <li>- The right to be nominated and to vote for cooperative's Management Board and Supervisory Board</li> </ul>	<p>Privilege memberships constitute the majority of clients.</p> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Those who pay for primary saving and compulsory saving in full.</li> </ul> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- Participation during RAT and voice in writing, but no voting rights</li> <li>- No right to be nominated neither to vote for cooperative's Management Board and</li> </ul>

<sup>8</sup> Full participation of members hasn't been fully exercised. Participation is carried through representation system during RAT.

Name of saving and loan cooperative	Semi Membership	Full Membership	Privilege Membership
		<ul style="list-style-type: none"> <li>- Entitled to receive dividend (SHU)</li> </ul>	<ul style="list-style-type: none"> <li>Supervisory Board</li> <li>- Entitled to receive dividend (SHU)</li> <li>- May upgrade to full membership by depositing Rp100million for equity</li> </ul>
Kospin Jasa (Quasi Bank)	<p>Semi memberships constitute the majority of clients.</p> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- Access to saving and loan services</li> <li>- No involvement in RAT</li> <li>- No right to be nominated neither to vote for cooperative's Management Board and Supervisory Board</li> </ul>	<p>Full membership makes up a small percentage of total clients:</p> <p><b>Membership entitlement:</b></p> <ul style="list-style-type: none"> <li>- Participation and voting rights during RAT</li> <li>- The right to be nominated and to vote for cooperative's Management Board and Supervisory Board</li> <li>- Entitled to receive dividend (SHU)</li> </ul>	<p>Privilege memberships constitute a small percentage of total clients.</p> <p><b>Requirement:</b></p> <ul style="list-style-type: none"> <li>- Contribute to equity</li> </ul> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- Invited to RAT but with no voting rights</li> <li>- Entitled to receive dividend (SHU)</li> </ul>
USPO Rukun Makmur (Saving and Loan Unit)	<p>Semi memberships constitute the majority of clients.</p> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- Access to saving and loan services</li> <li>- No involvement in RAT</li> <li>- No right to be nominated neither to vote for cooperative's Management Board and Supervisory Board</li> </ul>	<p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Member of Village Unit Cooperative (KUD), total number are 5200 people. So far only 60% of KUD members take advantage of the services provided by the saving and loan unit.</li> </ul> <p><b>Membership entitlement:</b></p> <ul style="list-style-type: none"> <li>- Participation in RAT</li> </ul>	
USP Swamitra Koppas Cipulir (Partnership)	<p>Semi memberships constitute the majority of clients.</p> <p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Those who haven't paid the primary and compulsory saving in full.</li> </ul> <p><b>Entitlements:</b></p> <ul style="list-style-type: none"> <li>- Access to saving and loan services</li> <li>- No involvement in RAT</li> <li>- No voting rights</li> </ul>	<p><b>Coverage:</b></p> <ul style="list-style-type: none"> <li>- Member of Koppas Cipulir, total number are 51 people.</li> </ul> <p><b>Membership entitlement:</b></p> <ul style="list-style-type: none"> <li>- Participation in RAT</li> </ul>	

From the table, it can be seen that the main distinction between full membership and other types of membership revolves around their participation in RAT and voting rights. Involvement in RAT indicates voting rights, unless stated otherwise. Semi and privilege membership options are reserved to expand outreach without giving the clients voting rights or involving them in RAT.

### **Funding sources and allocation**

According to the Law No 25/1992, equity for a cooperative consists of internal capital and borrowed capital. Internal capital comes from Primary Savings and Compulsory Savings from the members, Reserve, and Grants. For borrowed capital, they come from members' savings, placement from other cooperatives or their members, third party loans (banks or other financial institutions), the issuance of bonds, and other sources.

In general, there are 3 types of funding:

- Full self-sufficiency: the cooperative obtain all funding from primary savings and compulsory savings collected from its members. Belongs to this category is CU Pancur Kasih.
- Combination of internal and external sources: in addition to primary savings and compulsory savings collected from its members, the cooperative also obtains funding from third party loans. Belong to this category are Balo'ta, BMT Tamzis, Komida, USPO Rukun Makmur, and USP Swamitra Cipulir.
- Internal sources include insertion capital and issuance of bonds, in addition to primary savings and compulsory savings. Insertion capital acts more like a share and members who contribute to the insertion capital are the shareholders. Belong to this category is Kospin Jasa, it has higher amount of insertion capital than its primary savings and compulsory savings. Furthermore, its bonds have been converted to insertion capital.

### **Saving mobilization and loan disbursements**

According to the Government Regulation No 9/1995, saving and loan cooperatives are allowed to collect money from and disburse loans to its member as well as non-member clients. There are 3 categories with regard to saving and loan activities in relation to membership status:

- Mobilizing savings from members and privilege members and disbursing loans to members (examples: CU Pancur Kasih, KSP Balo'ta, Komida)
- Mobilizing savings from members and privilege members and disbursing loans to members and privilege members (example: BMT Tamzis)
- Mobilizing savings from members, privilege members, and semi members, and disbursing loans to members and semi members (examples: Kospin Jasa, USP Swamitra Koppas Cipulir, USPO Rukun Makmur)

From the featured examples above, saving services are applicable to all types or members while the target recipients of loan services are more restricted in nature. The cooperatives exercise different strategies in their saving mobilization efforts. A cooperative manager, based on his observation to the members, says that most people go to cooperatives because they believe it is a place to get loans and associate it with an easier process. Study by the World Bank to the Saving and Loan Cooperatives' Management Board mentioned earlier

shows that people prefer cooperatives than other financial institutions because of convenience and faster process. This preference is particularly related to loan applications. Therefore, when offering saving services, they need to be more creative. Some cooperatives offer a variety of saving products and are willing to go for the extra length to promote the habit for saving. One strategy is to tie the amount of saving to the maximum amount of loan a client may apply for. This policy is implemented by CU Pancur Kasih, KSP Balo'ta, BMT Tamzis, and Komida. It is a common practice for Saving and Loan Cooperatives to include saving in the calculation of loan collaterals. Some eliminate the requirement for collateral altogether and put saving as a substitute to secure the loan. Meanwhile, other cooperatives offer prizes as an incentive to save. Others also provide financial education, a special training session specially designed to educate the members on how to manage their finances and how to save.

For loan or financing products, the study to the Saving and Loan Cooperatives' Management Board finds that interest rate has not become a factor for clients in their application. Instead, they put convenience and faster process as the main considerations. In general, cooperatives charge higher interest rates than banks, or even than rural banks, because cooperatives also borrow money from banks and as a consequence have to charge extra for their margin. Yet, cooperatives have the advantage of flexibility in terms of collateral and administrative requirements that seem to be more favorable for the clients.

Some examples of collaterals that differ from bank requirements:

- Saving account in the same institution the person applying for loans
- Motorcycle certificate of ownership
- No requirement for business license of tax ID (NPWP)
- Joint liability (in group lending)

The flexibility is made possible by the very low range of loan amount (below Rp10,000,000, or even below Rp500,000), which is not applicable for banks.

### **Types of Financial Services**

Saving and Loan cooperatives, as the name suggests, offer saving and loan products. However, there is a great variety in terms of the products they offer. For saving products, the variety comes from saving purpose and duration, in addition to the yield (interest rate)<sup>9</sup>. For loan products, the variety comes from the purpose – whether it is for personal or family oriented (consumptive) purposes or for business (productive purposes). In the expansion of their services, the cooperatives also offer additional products such as security funds, whose types also differ from one cooperative to another. The different variety can be seen in the following tables.

**Table 5.4: Saving Services**

	Primary & Compulsory Savings	General / Daily Savings	Time Deposits	Needs-based Savings				
				Educa tion	Retire -ment	Housi ng	Auto- mobile/ Motor vehicles	Religio us purpose s
KSP Balo'ta	√	√	√	√	√			
Komida	√	√						
USP KUD Rukun Makmur	√	√	√					
BMT Tamzis	√	√	√					
CU Pancur Kasih	√	√	√	√	√	√	√	√
Kospin Jasa	√	√	√					√
USP Swamitra Koppas Cipulir	√	√	√					

Religious purposes for both saving and loan services refer to religious celebrations such as Christmas or Iedl Fitri festivals. It also refers to Hajj fund (pilgrimage activity for Moslems, in which they will need a certain amount of money and possibly have to save for years to afford the trip to Mecca in Saudi Arabia).

**Table 5.5: Loan Services**

	Productive Purposes	Consumptive Purposes	Education	Emergency	Religious Purposes
KSP Balo'ta	√	√	√	√	
Komida	√		√		
USP KUD Rukun Makmur	√	√			
BMT Tamzis	√				
CU Pancur Kasih	√	√	√	√	
Kospin Jasa	√				√
USP Swamitra Koppas Cipulir	√				



KUD Rukun Makmur has a distinct loan product that answers to the needs of its farmer members. They pay their loans upon harvesting of a four month cycle. Should there be problems with their farming, they can pay in the next harvest period while paying only the interest in between.

For the security funds, which mimic insurance schemes, the cooperatives provide different programs for their clients to protect them in the case of emergencies such as illness, hospital expenses, maternity labor, and death. Some also provide protection to the savings and to other claims. The summary can be seen in the table below:

**Table 5.6: Security Funds**

	<b>Allowance for Medication and Hospital Expenses</b>	<b>Allowance for Maternity Labor</b>	<b>Protection to Savings</b>	<b>Protection to Other Claims</b>	<b>Death</b>
KSP Balo'ta	√				√
Komida				√	
USP Rukun Makmur					
BMT Tamzis				√	
CU Pancur Kasih	√	√	√	√	√
Kospin Jasa					
USP Swamitra Koppas Cipulir					

Findings from the survey to the “Saving and Loan Cooperatives’ Management Board”, reveal many different products that has been created by the cooperatives in addition to the “insurance schemes”, with examples include:

- Advance for Umroh (another version of Hajj)
- Travel and ticketing services
- Financial advisory services
- Credit schemes for goods purchase
- Credit schemes for groceries
- Car rental
- Land purchase

Again, the examples show the flexibility of cooperatives in delivering services, in which there is unlimited possibilities to create saving and loan related products.

### **Risk Management Practices**

Risk management relates to the cooperatives’ strategy in dealing with repayment problems. In general, the cooperatives use of 5C (Character, Capital, Capacity, Condition,

and Collateral) for the screening of loan applications. Six of the seven require collaterals for the loans, with only Komida uses joint liability as a replacement for collateral.

In addition to collateral schemes, the cooperatives employ different strategies with examples include:

- Credit Crisis Center (C3) formed by Kospin Jasa following a method implemented in banking. This is a special unit to handle problem loans through legal actions.
- Protection schemes
- Smaller amount of loans to minimize risk
- Daily collection
- Loans tied to savings

Nevertheless, the cooperatives prefer a prevention strategy by knowing their clients and making a careful scrutiny prior to extending the loans.

### **Benefits for Members**

All the seven cooperatives show that they go beyond saving and loan products in their servicing the clients. They go the extra mile to the empowerment of the community (members) through financial education, as is done by CU Pancur Kasih, KSP Balo'ta, KOMIDA, and BMT Tamzis. The purpose is to promote the habit of saving and good personal financial management that will help the members increase wealth and improve their living standards. Another empowerment initiative is taken through group meetings, such as those done by Komida and CU Pancur Kasih, through which they conduct various trainings and bring unity to the groups.

### **Governance**

The discussion on governance will cover the human resources, supervision and reporting procedures, decision making process, and MIS/IT aspects.

Human resources are the most crucial part that can make or break an organization. The seven featured cooperatives show their commitment to good human resource management through:

- Hiring people with good educational backgrounds for managerial positions, university education of associate degree or higher.
- A recruitment process that has to go through a number of steps, with some have a specific Standard Operating Procedure for the recruitment process. Recruitment can be done by the headquarter (such as BMT Tamzis and CU Pancur Kasih) or by the branches (such as Kospin Jasa). There are two cooperatives (Komida and KSP Balo'ta) that recruit the family members of their clients for the purpose of creating employment for the cooperatives' members.
- Training and development program, whether organized through internal training facilities or sending their staff to external training programs (such as those provided by the government, secondary cooperatives, banking, and donor agencies).
- On the job training for new recruits.
- Compensation above the minimum wage requirement or civil servant's salary range. Some cooperatives require their staff to become members so that they are entitled for profit sharing.
- An organization structure with clear division of roles and responsibilities. Some cooperatives assign separate roles between operational staff, who report to Management Board and Supervisory Board, and Management Board and Supervisory Board, who report to the Annual Member Meeting (RAT).

## 6. CONCLUSION

All the seven featured cooperatives have developed some type of supervision and reporting procedures. In general, the reporting goes from the operational staff to the Management Board and Supervisory Board, with the reporting mainly consists of financial reporting and loan disbursement status. Special meetings will be conducted between operational staff, Management Board, and Supervisory Board to discuss non-performing loans and collection problems. The majority of them have internal audit team (KSP Balo'ta, KOMIDA, BMT Tamzis, Kospin Jasa, and CU Pancur Kasih), and all (except CU Pancur Kasih) has their financial reports audited by external auditors. All the cooperatives send their regular reports to the Local and National Ministry of Cooperatives, and to their secondary cooperatives where applicable.

For the decision making process, the seven cooperatives show different practices despite the fact that all conducted through their RAT mechanism. In general, policy making is done through RAT with a representation system, while operational decisions are made by operational staff in consultation with Management Board, and Supervisory Board. Representation system is put in place due to the large number of members, coupled with their scattered locations, that makes it nearly impossible to gather all the members in one place for the voting activities. Therefore, they exercise a pre-RAT mechanism to have the representation system in several stages, starting with meeting in groups followed by pre-RAT meetings. The actual RAT are attended by quota-based representatives selected during group and pre-RAT meetings. The representation system is mainly applicable for those with full membership system such as CU Pancur Kasih and KSP Balo'ta. Meanwhile, for those who apply layers in their membership system (semi-full-privilege), it is possible for them to have full attendance as they only have limited number of people with full membership status (who earn the voting rights). Examples include BMT Tamzis, Kospin jasa, and USP Swamitra Koppas Cipulir.

Although RAT is the ultimate reflection of the “togetherness” value, which support the “by the people and for the people” philosophy, the cost factor should be taken into consideration. To organize a full blown RAT is very expensive and cooperatives need to work around it.

For Kospin Jasa, which aim at swift response to competition with their “banking practice”, they can have decisions made through internal meetings between operational staff, Management Board, and Supervisory Board. They resort to this practice to expedite the process and enable them to make decisions without having to go through the RAT mechanism.

One of the big decisions made during RAT is the distribution of profit sharing or SHU. The study found that all the seven cooperatives promote transparency and accountability in their profit sharing policies. They announce the amount openly during the RAT and ask for consensus regarding the allocation and the percentage. In average, they give back 30-50% of the profit to the members, although their definition for members, those who are entitled to receive SHU vary from one to another.

Findings from the survey to the “Saving and Loan Cooperatives’ Management Board” show the average distribution of Profit Sharing (SHU) is as follows:

- 40% for members

- 20% for business expansion
- 7% for training and development
- It is estimated that the remaining 33% is allocated for the benefits of Management Board and operational staff

Conclusion on this study specifically refers to a previous study conducted in 2013 by the World Bank team<sup>10</sup> on “The Different Business Models of Saving and Loan Cooperatives in Indonesia”. The study features case studies on seven saving and loan cooperatives (KSPs) / saving and loan cooperative units (USPs), which consisted of:

1. KSP Ba’lota, Toraja
2. Kospin Jasa, Pekalongan
3. CU Pancur Kasih, Pontianak
4. BMT Tamziz, Wonosobo
5. Koperasi Mitra Dhuafa (KOMIDA), Jakarta
6. USPO Rukun Makmur, Madiun
7. USP Swamitra Cipulir, Jakarta

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<sup>10</sup> The study on “The Different Business Models of Saving and Loan Cooperatives in Indonesia” was conducted by the World Bank in collaboration with Ministry of Cooperatives (Kemenkop) and the National Planning Agency (Bappenas). The purpose of the study is to gain a better understanding of the different practices and business models exercised by saving and loan cooperatives in Indonesia, particularly on the internal and external influencing factors that lead them to their current practices. Internal factors include governance and membership while external factors include network, competition and market opportunities. The study was conducted through Focus Group Discussions (FGDs), in-depth interviews, and observation, in addition to literature reviews.

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# **INFLATION TARGETING AS AN ANCHOR OF MONETARY POLICY IN DEVELOPING ECONOMIES – A STUDY WITH SPECIAL REFERENCE TO INDIA**

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## **ABSTRACT**

Inflation targeting as a monetary policy strategy has been a subject of intense debate of late, especially in India, against the backdrop of the recommendations of the Dr. Urjit Patel Committee set up by the Reserve Bank of India (RBI). This theoretical paper analyzes, in the context of the current macroeconomic conditions prevailing in India and also in light of the experience of other emerging market economies, whether inflation targeting would be a viable monetary policy framework to be pursued by the RBI. Though it is argued that an institutional commitment to predictable and low inflation rates would lead to greater monetary stability, the practicality of fulfilling such a commitment in an economy like India where a significant proportion of inflation is caused by factors such as supply side shocks, which are beyond the control of the Central Bank has always been in question. To hold the Central Bank accountable for something which it can only influence to a limited extent, may in fact, end up damaging its credibility. Also, in the present globalized world where economies are subject more than ever before to external shocks which may require divergent policy responses, this paper tries to analyze whether an inflation targeting regime would come in the way of effective monetary policy response. Finally, this paper also discusses the institutional and economic pre-conditions that are required to be put in place before an economy can adopt inflation-targeting as an anchor for monetary policy.

**Keywords:** Inflation targeting, monetary policy framework, central banking.

## **INFLATION TARGETING AS AN ANCHOR OF MONETARY POLICY IN DEVELOPING ECONOMIES – A STUDY WITH SPECIAL REFERENCE TO INDIA**

### **Inflation Targeting**

Inflation targeting is a monetary policy strategy followed by central banks to maintain inflation at a certain level or in a narrow band around a certain level. The strategy of inflation targeting usually involves the following:

1. Public announcement of targeted inflation rate over the medium term by the central bank, leaving some leeway for unavoidable economic shocks;
2. Official recognition of price stability as a primary goal of monetary policy by the central bank, subordinating other goals; and
3. Increased accountability of central banks in achieving the set objectives of monetary policy.

### **Evolution of Inflation Targeting**

Inflation targeting as a monetary policy strategy gradually evolved after the collapse of the Bretton Woods fixed exchange rate system. One of the first proponents of inflation targeting was the Bundesbank – the central bank of Germany, which set the targets of growth in money supply with reference to the banks' long term desired inflation rate, which was 2%. There is evidence to suggest that when conflicts arose between growth and inflation, the Bundesbank gave priority to inflation, subordinating growth (Bernanke & Mihov, 1997). However, the Bundesbank was certainly not explicit in its communication about its inflation targets and hence the thesis that it did actively follow inflation targeting as a monetary policy strategy is not unquestioned.

The central bank of New Zealand was the first to adopt inflation targeting, in its true sense, in 1989. In the 1990s other developed nations joined the league with the central banks of Australia, Sweden, Canada and England also adopting inflation targeting. Soon, this policy framework was adopted by developing economies like Thailand, Brazil, Philippines, Chile, Mexico and South Africa. The US Federal Reserve, though pursuing an unofficial inflation target for a long period of time, made its inflation targeting policy official in January 2012, when it announced that it would pursue a policy which targets a 2% rate of inflation, as it believed that such a policy would be most consistent over the long run with the Federal Reserve's statutory mandate. The European Central Bank (ECB) has also formally announced an inflation target of up to 2%.

Originally, inflation targeting was interpreted by many policy makers as giving sole priority to maintaining the inflation rate around the targeted level. This made some policy makers skeptical about the long-run viability of the approach of inflation targeting because mere price stability without output near full employment levels would have negative implications in the long-run. As a result, the original and somewhat rigid form of inflation targeting evolved further into what is known as flexible inflation targeting (FIT). In FIT, the focus is on keeping inflation expectations anchored even when actual inflation may deviate from the target at times, in order to achieve near-full employment conditions in the economy.



In March 2015, in line with the recommendations of the Dr. Urjit Patel Committee, the Reserve Bank of India, India's central bank, formally adopted inflation targeting as its guide to monetary policy, by announcing that it would target an inflation of 4% in the medium term.

However, the debate surrounding the suitability of inflation targeting in an economy like India still continues.

### **Arguments in favour of inflation targeting as a nominal anchor**

A nominal anchor is central to a transparent and credible monetary policy framework. It helps in tying down the final goal of monetary policy in the medium to long run and the expectations of economic agents adjust accordingly. Inflation targeting also reduces the likelihood of the central bank falling into a time inconsistency trap. The source of time inconsistency is often found in the form of political pressures on the central bank to follow an over-expansionary monetary policy. Inflation targeting discourages such pressures, as the accountability of the central bank towards meeting its inflation targets is well publicized.

Inflation targeting has gained popularity as a nominal anchor because of the several advantages that it has over other anchors such as exchange rate peg and monetary targeting. An exchange rate peg exposes the economy to potential external shocks, particularly those emanating from the anchor economy. In contrast, inflation targeting helps monetary policy to focus on domestic considerations.

Monetary targeting refers to a policy whereby the central bank announces that it will achieve a certain value of annual growth rate of a monetary target. It is argued that monetary policy can influence monetary growth rates to a much greater extent than it can influence inflation because of the long time lag involved in the transmission of monetary policy actions. However, the main advantage of inflation targeting over monetary targeting is its visibility. A much larger portion of the population understands the meaning of inflation as opposed to monetary growth. This plays a crucial role in managing inflation expectations.

Another major advantage of inflation targeting is the transparency of policy associated with it. If the central bank has sufficient credibility that the economic agents believe that the inflation target will be hit, they would in turn negotiate their returns (such as wages, rent, etc.) on the basis of low and stable inflation expectations. Thus, the policy would be self-reinforcing: low inflation expectations would lead to low inflation, confirming the low expectations and so on.

It is also argued that price stability is a pre-condition for sustainable growth in the medium run, though a trade-off between inflation and growth is inevitable in the short run. Empirical evidence suggests that countries that have adopted inflation targeting have tended to have lower and more stable inflation after the change than before.

Another variant of inflation targeting that is being actively considered by some central banks is price level targeting. In price-level targeting, the central bank would adjust its monetary tools, which typically are short term interest rates, in an effort to achieve a pre-announced level of prices over the medium term. This approach differs from inflation targeting, as inflation targeting endeavors to achieve a pre-announced level of increase in prices. Price-level targeting could have some potential benefits over inflation-targeting.

Particularly in the economic environment in developed economies, where policy rates have fallen to near zero, price-level targeting could help support positive inflation expectations, thereby stimulating growth. However, a major hurdle in the approach of price-level targeting is the complexity involved in communicating the price targets to the masses.

### **Evolution of monetary policy framework in India**

In the early years after gaining independence in 1947, monetary policy in India was characterized by an exchange rate anchor. In 1957, this policy was replaced by the use of credit aggregates as the nominal anchor. Cash Reserve Ratio (CRR) and Bank Rate were the main policy tools in the hands of the Reserve Bank of India (RBI), which focused on selective credit control and enhancing flow of credit to socially important sectors.

The period of 1971-85 was characterized by heavy fiscal deficits as a result of the public sector oriented growth model adopted by the government. The resultant monetization of the fiscal deficit exerted considerable inflationary pressures on the economy and the central bank had to often use the CRR to neutralize inflation. Credit to the private sector remained subdued during this period.

After 1985, in line with the recommendations of the Committee to Review the Working of the Monetary System, monetary targeting was adopted as a nominal anchor to monetary policy. However, evidence suggests that the monetary targets set by the central bank were rarely met. The biggest hurdle in achieving this end was demand for credit from the government in wake of high fiscal deficits and the lack of control of the RBI over such demand. Further, with the opening up of the Indian economy in the 1990s and the resultant capital flows, controlling monetary aggregates became difficult than ever before. With the economy being exposed to global dynamics, volatility in exchange rates and transmission of external shocks imparted considerable instability to demand for money.

Eventually in 1998, the RBI adopted a multiple indicator approach to monetary policy. As per this approach, the RBI would consider a number of factors such as inflation, exchange rates, fiscal position, demand, output and credit growth in formulating monetary policy. The focus also shifted from controlling monetary aggregates to influencing economic activity predominantly with the tools of interest rates. The multiple indicator approach worked fairly well till 2008-09, with an average real GDP growth rate of around 7.1% and average Wholesale Price Index (WPI) as well as Consumer Price Index (CPI) based inflation of around 5.5%. However, since 2008-09, though GDP growth rate has been moderating, inflation has tended to remain at fairly elevated levels. These signs of stagflation reopened the debate about whether the multiple indicator approach was the right one to pursue. Critics of this approach argued that using a large spectrum of indicators did not provide a clearly defined nominal anchor for monetary policy. It also created uncertainty about the precise indicators that the RBI took into consideration while framing monetary policy.

**Table 1: Mean Inflation Rates in India and Contribution to Overall Inflation**

Year	WPI	Contribution to inflation in percentage points			
		Food Items	Non-food Articles	Fuel Group and Minerals	Non-food Manufacturing
1990-91	10.3	2.8	0.7	1.1	5.3
1991-92	13.7	4.5	0.8	1.2	6.9
1992-93	10.0	2.9	0.0	1.2	7.1
1993-94	8.3	1.8	0.4	1.6	4.6
1994-95	12.6	3.7	1.0	1.0	7.5
1995-96	8.0	1.1	0.4	0.5	6.1
1996-97	4.6	2.0	0.0	1.1	0.8
1997-98	4.4	1.5	0.1	1.4	1.1
1998-99	5.9	2.8	0.5	0.4	1.7
1999-00	3.3	1.6	-0.3	1.0	1.8
2000-01	7.2	-0.8	0.1	3.4	2.9
2001-02	3.6	-0.1	0.2	1.3	1.3
2002-03	3.4	0.9	0.3	0.8	1.1
2003-04	5.5	1.6	0.5	1.0	2.7
2004-05	6.5	0.9	0.0	1.8	3.6
2005-06	4.4	0.9	-0.1	2.2	1.5
2006-07	6.6	1.9	0.2	1.4	3.1
2007-08	4.7	1.4	0.5	0.2	2.7
2008-09	8.1	2.2	0.5	2.2	3.1
2009-10	3.8	3.6	0.2	-0.1	0.1
2010-11	9.6	3.0	1.0	2.4	3.1
2011-12	8.9	2.0	0.5	2.9	3.6
2012-13	7.4	2.5	0.5	1.9	2.4
2013-14	6.0	2.1	0.3	1.6	2.0
2014-15	2.1	0.9	0.0	-0.1	1.3

Source: Patel (2014)

Finally in March 2015, in accordance with the recommendations of the Expert Committee to Revise and Strengthen the Monetary Policy Framework, headed by Dr. Urjit Patel, Deputy Governor of RBI, the RBI formally announced a shift in its policy towards adopting inflation targeting as a nominal anchor of monetary policy.

### **Challenges in implementation of inflation targeting in India**

For a long time, questions have been raised about the practicality of inflation targeting as a nominal anchor of monetary policy in an economy like India. The primary hurdle has been the way in which inflation is measured in India. Until recently, the central bank communicated inflation projections based on the Wholesale Price Index (WPI) alone, essentially because it was the only measure of prices at the national level. The WPI is an imperfect substitute to the Producer Price Index (PPI). Importantly, it does not capture price movements in non-commodity producing sectors such as services, which account for close to two-thirds of the economic activity in India. Additionally, all prices taken for the calculation

of WPI are not wholesale prices. Prices of commodities such as milk, for example, are taken from the retail markets. WPI is also subject to large revisions, which are made two months after the initial numbers, causing considerable uncertainty in the assessment of inflation.

The true inflation that consumers face is in the retail market. So the correct measure of inflation that must be targeted in the Consumer Price Index (CPI). It is only since October 2013 that the RBI has been providing indicative projections of inflation in terms of CPI. Though, unlike the WPI, the CPI has not been subject to large revisions, improvements in the index would lead to the CPI being a more representative measure of inflation conditions in the economy.

The biggest concern that has been raised in India in its pursuit of inflation targeting is about the ability of the RBI to effectively deliver on the inflation target. This is because around 50% of the inflation in India emanates from items such as food and fuel, which are susceptible to supply side shocks and are effectively outside the ambit of monetary policy. This is in contrast to developed economies and also many emerging market economies, where food and fuel contributes a much smaller proportion to the overall inflation basket and hence monetary policy has a greater influence on inflation.

**Table 2: Statement showing weights assigned to product groups in India’s WPI basket**

<b>Major Group / Groups</b>	<b>Weights</b>
<b>Primary Articles</b>	<b>20.118</b>
Food Articles	14.337
Non-Food Articles	4.258
Minerals	1.521
<b>Fuel and Power</b>	<b>14.910</b>
Coal	2.094
Mineral Oils	9.364
Electricity	3.452
<b>Manufactured Products</b>	<b>64.972</b>
Food Products	9.974
Beverages, Tobacco	1.762
Textiles	7.326
Wood and Wood Products	0.587
Paper and Paper Products	2.034
Leather and Leather Products	0.835
Rubber and Plastic Products	2.987
Chemicals and Chemical Products	12.018
Non-Metallic Mineral Products	2.556
Basic Metals, Alloys and Metal Products	10.748
Machinery and Machine Tools	8.931
Transport Equipments and Parts	5.213

Source: Patel (2014)

It is argued that inflation targeting could work in India so long as global commodity prices remain benign. But in the event of an external shock in the form of a sharp rise in

prices of commodities such as crude, or an internal shock in the form of high food inflation due to vagaries of the monsoon, the RBI would find it difficult to keep inflation expectations subdued. This would in turn hurt its credibility, which would severely damage the very foundations of the strategy of inflation targeting. On the other hand, in order to maintain credibility, if the RBI keeps interest rates very high during such periods, it would severely hurt domestic growth, besides also creating potential conflict points between the government and the central bank. Either outcome could be damaging to the economy in the medium run.

Another source of inflationary pressures are minimum support prices (MSPs) announced by the government in case of agricultural products to insure farmers against sharp fall in farm prices. In recent years there has been a sharp increase in MSPs, thereby exerting upward pressure on food inflation. The design of programmes like the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGA) and the Food Security Act are also responsible for an upward pressure on inflation. The MGNREGA scheme provides hundred days of guaranteed wage employment in a financial year to rural household who volunteer to do unskilled manual work. However, this results in a sustained upward pressure on nominal wages, without a commensurate increase in productivity. The Food Security Act, on the other hand, aims to provide subsidized food grains to approximately two-thirds of India's population. This has the potential to increase the demand for food grains, without any efforts to augment supply. Such a policy induced wage-price spiral can be damaging to the inflation targeting framework, as it can impose constraints on the ability of the central bank to influence inflation.

The other major hurdle in the way of inflation targeting in India is inefficient monetary policy transmission. A central bank can influence inflation and inflation expectations only if its policy moves are transmitted effectively into the economy. Monetary policy transmission, though having improved in India in the past few years, still has a long way to go. For example, a policy rate move by the central bank does not always lead to an equivalent move by banks. Banks find it difficult to cut lending rates immediately since their cost of deposits takes time to adjust, given the fixed nature of deposits. The presence of investment options like post office schemes, whose interest rates are administered and are not adjusted in line with prevailing interest rates, also poses a risk to banks of flight of deposits, if they were to cut interest rates on deposits too much and too quick. However, banks can raise lending rates far more quickly in response to a policy rate hike, as most loans are floating rate loans and therefore re-pricing is easier. This asymmetry in monetary policy transmission can potentially act as a major constraint in achieving the objectives of inflation targeting.

It is also argued that in a developing economy like India, it would not be advisable for the central bank to subordinate the objectives of growth and employment and focus on inflation alone. In doing so, the central bank risks trying to control something that it anyway cannot fully influence, and in the process ending up damaging the larger development context. In a country like India, the central bank cannot wish away the difficult trade-off between inflation and growth in determining monetary policy.

Another drawback of the policy of inflation targeting in an economy like India is that it could severely limit the policy space available with the central bank while responding to external shocks that are transmitted to the economy through the exchange rate channels. In fact, emerging economies like India are vulnerable to erratic moves in the exchange rates due to changes in global capital flows caused by factors beyond the control of the RBI. The

volatility in exchange rates could be higher especially in phases when the economy runs a higher trade and current account deficit (CAD). Given the nature of the trade deficit of India - with crude, whose demand is relatively price inelastic and gold, whose demand is subject to speculative tendencies - forming a major part of India's imports, it is likely that the economy would periodically have to endure bouts of exchange rate volatility. The need to respond to such a situation may require the central bank to deviate, even though for a limited period, from its inflation targeting focus.

Finally, an inflation targeting regime may fail if the government does not keep a check on its fiscal deficit. In the long run, large fiscal deficits may have to be monetized, causing considerable upward pressure on inflation. Hence, setting up an institutional framework that would help keep fiscal policy in check is crucial for the success of inflation targeting. In India, such an effort was made through the Fiscal Responsibility and Budget Management (FRBM), Act, 2003. As per the provisions of the FRBM Act, the government was to bring down fiscal deficit to 3% of GDP by March 2008. However, due to the global financial crisis of 2008, the deadline for the implementation of the target was initially postponed and subsequently suspended. The fact is that India has still not been able to meet the target, with fiscal deficit for FY 2014-15 being reported at 4% of GDP.

However, achieving better fiscal discipline is a pre-requisite for inflation targeting or a result of it, it debatable, particularly in light of the evidence from some of the countries which have adopted inflation targeting. The evidence suggests that fiscal discipline turned out to be the biggest immediate advantage of formal adoption of inflation targeting.

**Table 3: Fiscal Balances of Countries in the Year of Adopting Inflation Targeting and in 2007**

Country	Year of Adopting Inflation Targeting	Fiscal Balance in the Year of Adopting Inflation Targeting (Per cent of GDP)	Fiscal Balance in 2007 (Per Cent of GDP)
Chile	1990	3.5	8.4
Israel	1990	-4.4	-0.2
Australia	1993	-3.9	1.5
Canada	1990	-4.9	1.6
Finland	1992	-8.1	5.2
New Zealand	1990	-1.7	2.5
Spain	1994	-4.9	1.9
Sweden	1992	-9.8	3.7
UK	1992	-7.2	-2.7
Brazil	1999	-6.9	-2.6
Czech Republic	1998	-1.6	-0.7
Poland	1999	-5.0	-1.9
South Africa	2000	-2.7	1.2
Thailand	2000	-2.2	0.2

Source:

1. IMF (2001)
2. IMF (2010)

## **Inflation targeting in an environment of high inflation: Lessons from Chile and Czech Republic**

Inflation in India has been persisted at high levels in the last few years. In this context, there could be important lessons for policymakers from the experience of Chile and Czech Republic. Chile adopted the policy of inflation targeting in September 1990, when its inflation was in excess of 25%. The Central Bank of Chile adopted a target of bringing down inflation in the range of 15-20% in 1992. For every successive year, the range was gradually brought down. In 1995, it switched over to a point target of 8%. This was gradually brought down to 3.5% in 2000. After reaching a fairly steady rate of inflation in 1999, the Central Bank announced an inflation target of 2% with a tolerance band of 1% in either direction. Thus, over a period of a decade, the Central Bank of Chile was able to bring down inflation from hyper-inflationary levels to its target of 2%.

The Czech Republic switched to inflation targeting in December 1997 by announcing a medium term inflation target for end 2000, in the range of 3.5-5.5 per cent. In 1999, it announced a long-term target of 1-3 per cent for December 2005. In January 2006, it announced an inflation target of 3 per cent with a tolerance level of 1 per cent in either direction. In January 2010, the inflation target was brought down to 2 per cent.

### **CONCLUSION**

The International Monetary Fund has described inflation targeting as “a pragmatic response to the failure of other monetary policy regimes”. Inflation targeting has been successfully adopted by a number of countries in the past two and a half decades. Most countries that have pursued inflation targeting have been able to achieve and maintain price stability over a period of time. However, how much of this price stability can be attributed to inflation targeting and how much to a soft global growth environment, particularly in the last few years, is debatable. Critics of inflation targeting also allege that the policy has been unsuccessful in identifying and acting upon asset-price bubbles, as was evident in the global financial crisis of 2008.

With all its limitations and criticisms, there is evidence that inflation has globally served as a better anchor to monetary policy than money supply or exchange rates. However, the transition from the multiple indicator approach to the inflation targeting approach has to be carefully drafted in an economy like India. It is true that the inflation targeting strategy could enhance the credibility of the central bank and make it accountable for achieving a specific objective. However, in absence of the institutional requirements that would allow the central bank to pursue its goal of inflation targeting efficiently, it could end up damaging the credibility of the central bank. Most importantly, the government needs to commit itself to a path of fiscal consolidation and publicly communicate the roadmap towards achieving it. Secondly, there is a need to speed up financial sector reforms and gradually reduce the prevalence of administered prices and interest rates, which are significant impediments to monetary policy transmission. Thirdly, even though the RBI may not be in a position to significantly influence supply side inflation such as that caused by food and fuel, it would always have to be vigilant on this front and take pre-emptive steps to fend off a possible spike in inflation caused by supply shocks, because food and fuel inflation has the potential to substantially increase inflation expectations, as compared to core inflation. Inflation targeting, if successful in anchoring inflation expectations in India, will not only enhance the

credibility of the RBI, but will also serve in a big way in putting the economy back on the path of sustainable growth.



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# **INDEPENDENT OR INTERDEPENDENT EFFECT BETWEEN STOCK PRICE AND VOLUME: EVIDENCE FROM INDIAN STOCK MARKET**

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## **ABSTRACT**

The recent history of the stock market for the whole world has been characterized by sharp downward price movements accompanied by high volume and associated with increased future volatility. The country India is not coming under any exception of the same. This paper tries to explore the causal relationship between stock prices and volume figures for stock markets of India particularly in Bombay Stock Exchange by making use of monthly data from April 2000 to March 2015. Prior to running causality tests, the time series properties of the data have been carefully investigated and special attention have given to the choice of optimal lag order. The unit root tests results has already confirmed that all variables are stationary and they are co-integrated, indicating the presence of long run equilibrium relationship between them. Granger causality tests procedure revealed a unidirectional casual relationship from stock Price to Volume for Indian Stock Market. These results have some important implications regarding market efficiency and the effects of characteristics on the stock price/volume relation.

Key words: India, Granger causality test, market turnover, stock prices, volume.

# **INDEPENDENT OR INTERDEPENDENT EFFECT BETWEEN STOCK PRICE AND VOLUME: EVIDENCE FROM INDIAN STOCK MARKET**

## **1. INTRODUCTION**

The stock market may appear daunting at times, but it is a system that has proven to be effective and accessible for all types of investors. The role of the stock market also provides risk diversification, liquidity, information processing, and capital mobilisation in promoting economic growth. Stock market influences national savings and its allocation and financing decisions of firms, leads to a stable health of the economy to large extent (Naceur & Ghazouani, 2007)

The growing importance of stock markets in developing countries around the world over the last few decades has shifted the focus of researchers to explore the relationship between stock market development and economic growth (Cooray, 2010; Caporale et al., 2004; Harris, 1997; Levine, 1996). The role of stock market in the process of development has been well recognized. A developed stock market has been considered crucial for national economic growth as it provides an additional channel (along with banks and other financial institutions) for encouraging and mobilizing domestic savings and ensures improvements in the productivity of investment through market allocation of capital.

The stock market may influence national savings and its allocation and financing decisions of firms before paving the growth. The stock market plays a significant role in the health of the economy. The economy has to be strong for its country and its citizens to prosper. Being an important pillar of the economy of a country, the stock market plays a pivotal role in the growth of the industry and commerce which ultimately affects the economy of the country to a large extent. This is the rationale that the industrial bodies, government advisors and even the central bank of the country keep a close eye of observation on the activities of the stock market.

The Indian Equity market is divided in to two parts Primary market - where the share is first issued in the form of IPO (Intial Public Offering) and after issuing the share it is listed on exchange and share is traded on exchange where shares can be bought and sold this is secondary market. Most of the trading in the Indian stock market takes place on its two stock exchanges: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The BSE has been in existense since 1875.

At the last count, the BSE had about 4,700 listed firms, whereas the rival NSE had about 1,200. Out of all the listed firms on the BSE, only about 500 firms constitute more than 90% of its market capitalization; the rest of the crowd consists of highly illiquid shares. The one prominent Indian market index is Sensex. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 45% of the index's free-float market capitalization. It was created in 1986 and provides time series data from April 1979, onward.

The overall responsibility of development, regulation and supervision of the stock market rests with the Securities & Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market

rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach.

## **2. LITERATURE REVIEW**

The activities on a stock market tend to be specialized and not understood by common people, this chapter will give some basic definitions and review stock market history, participants, operations and importance, so as to serve as a basis for understanding how stock market can help promote investment and trade in a monetary zone (Niederhoffer, 1968; Crouch, 1970; Baker et al., 2003; Molodovsky, 1968).

The Indian capital market has changed dramatically over the last few years, especially since 1990. Changes have also been taking place in government regulations and technology. The expectations of the investors are also changing. The only inherent feature of the capital market, which has not changed is the 'risk' involved in investing in corporate securities. Managing the risk is emerging as an important function of both large scale and small-scale investors.

Few literatures which depict the relationship between the stock price and volume are presented here. Stosic et al. (2015) studied auto-correlations and cross-correlations of daily price changes and daily volume changes of thirteen global stock market indices. They find that there is an absence of correlations in price changes, there are anti-persistent long-term correlations in volume changes, and there are anti-persistent long-term cross-correlations between price and volume changes. Shuffling the series reveals that multi factuality of both price changes and volume changes arises from a broad probability density function. Similarly, Azevedo et al. (2014) examine the stock price and volume effects associated with changes in the composition of the FTSE Bursa Malaysia Kuala Lumpur Composite Index. The results show significant changes in liquidity causes trading volume and stock prices to reverse back to their original level before the index revisions took place.

The stock prices also have a significant volatility presented both for Indian and Chinese stock market, which has studied by Tripathy and Rahman (2013). Their results demonstrated that there are significant ARCH effects in both the stock markets, and it is appropriate to use the GARCH model to estimate the process. Also, Yuan et al. (2012) studied the cross-correlation between stock prices and trading volume is empirically studied using cross-correlation function and detrended cross-correlation analysis. It is found that both Shanghai stock market and Shenzhen stock market show pronounced long-range cross-correlations between stock price and trading volume.

In the literature of Huddart et al. (2009), who studied the relationship of past prices and how it influence investors' trading decision. They found that volume spikes when price crosses either the upper or lower limit of the past trading range, then gradually subsides. Like wise, Gnnduz and Hatemi (2005) studied the causal relationship between stock prices and volume figures for stock markets in the Czech Republic, Hungary, Poland, Russia, and Turkey. The result reflects different market characteristics on the stock price/volume relation. And, Apte (1997) investigates the role of stock prices in influencing demand for money in India using a multivariate cointegration analysis framework. The results show evidence of bi-directional causality between money and industrial production and unidirectional causality

from money and industrial production to stock prices though the evidence on this is rather mild.

Stickel and Verrecch (1994) studied on how trading volume influences subsequent price change. The result shows that as volume increases, the probability that the price change is information driven increases. The evidence indicates that large price changes on days with weak volume support tend to reverse, at least partially, the next day. Similarly, Gallant et al. (1992) studied price and volume co-movement using daily New York Stock Exchange. The results show a large price movements are followed by high volume. Comparably, Kreag (1953) studies to forecast the stock market moves. He finds that the stock market is not a linear function, and, if it were, the least-square line is merely a convenient method of calculation.

### **3. LITERATURE GAP**

From the available literature, the following gaps are identified:

- Few studies have been made on India, particularly with respect to Stock Price and Volume.
- In the studies made so far, few stock market development indicators have been used for examining causality effect between stock price and Volume.
- Very few studies have been made so far on the impact of stock price and volume, particularly on India.
- To the best of my knowledge, none of the studies considered the direction of stock price on volume in India.

### **4. OBJECTIVES OF THE STUDY**

The primary objective is to fit a causal relationship between stock prices and volume figures for Bombay Stock Exchange. Prior to running causality tests, the time series properties of the data is to be carefully investigated and special attention would given to the choice of optimal lag order. More specifically, this paper aims

- To find out the unit root problem for Stock Price and Volume to confirm that all variables stationary;
- To know the return characteristics for both the stock price and volume through descriptive statistics;
- To measure the presence of long run equilibrium relationship through co-integration test.

### **5. DATA AND METHODOLOGY**

This paper tries to explore the causal relationship between stock prices and volume figures for stock markets of India particularly in Bombay Stock Exchange. The scope of the study is limited to the past 16 financial years—i.e., April 2000 to March 2015 (depending upon the availability)—data of Bombay Stock Exchange (BSE). The monthly closing values of BSE have been taken for 192 observations.

We have used BSE Sensex as a proxy for the stock market because it is the major value based representative of the Indian stock market. Further out of all the listed firms on the BSE, only about 500 firms constitute more than 90% of its market capitalization. The previous research works which have tested the stock prices in influencing demand for money in India is Apte (1997).

The study is based mainly on the secondary data which have been collected from the official website of BSE (<http://www.bseindia.com/>).

The Long term equilibrium relationships between stock price and volume have been examined by applying following statistical tests:

### 5.1 Unit Root Test (Augmented Dickey-Fuller Test)

Unit root test is devised to check whether the series is stationary or non stationary. The data are made into stationary by applying Augmented Dickey-Fuller (ADF) test as both co-integration and Causality techniques require that all data sets to be normalized. The ADF test follows the estimation of the following equation:

$$\Delta Y_t = B_1 + Z Y_{t-1} + \alpha_i + \sum_t$$

Where,  $B_1$  refers to the intercept.  $T_t$  and  $Y_{t-1}$  is the individual variable and it's lag respectively.

### 5.2 Johansen Test for Cointegration

Johansen Juselius Cointegration test is performed to examine the number of independent linear combinations between dependent and independent variables. This test is based upon Maximum Eigenvalue and trace test. For the long run relationship test, we apply Johnson-Juselius (JJ) test, which follow the following equation:

$$\Delta X_t = \sum \Gamma_i \Delta X_{t-1} + Z X_{t-1} + \sum_t$$

Where,  $\Gamma_i$  and  $Z$  are estimated parameters;  $Z X_{t-1}$  is the Error correction term;  $\sum_t$  is the Vector of the residual.

### 5.3 Vector Error Correction Model (VECM)

Vector Error Correction Model uses t- statistics. This model aids in calculating short run dynamics of long run relationship.

### 5.4 Testing for Lead – Lag Relationship

The lead lag relationships between the variables have been examined by following Granger Causality Test. This test is used to determine the causal analysis. The logic behind this test is that future cannot cause the past but the past can cause the future. If past value of time series X significantly contribute to forecasting Y then X is said to be Granger cause of Y. For the Causality relationship test, we apply Granger Causality test, which follow the following equation:

$$SMP_t = C1 * SMV_{t-i} + C2 * SMP_{t-j} + u_{1t}$$

Where:

SMP is the Stock Market Performance at Period t

SMP is the Stock Market Price; SMV is the stock market Volume at Period t

C1 and C2 are the respective Coefficient

t-i and t-j are the lag period, and  $u_{1t}$  is the residuals of the model.

## 6. DATA ANALYSIS

The purpose of this study is to investigate the relationship between stock price and volume in India. To capture this, time series stock market data were culled from April 2000 to March 2015, covering 16 financial years. The study has to underscore the importance of the stock price in influencing stock volume and vice-versa in India. The model was implemented in EViews ver 7. Inputs to the software are the variable data, like: closing price and volume of Bombay Stock Exchange.

**Table 1: Descriptive Statistics of Daily Returns**

Basis	Closing Price	Volume
Observation Period	July 2003-April 2015	July 2003-April 2015
Number of Observation	142	142
Mean	15110.25	20354.23
Median	16386.77	17300
Maximum	29220.12	61400
Minimum	3792.61	8400
Std. Dev.	6248.481	10570.97
Skewness	0.038689	1.573785
Kurtosis	2.464727	5.605065
Jarque-Bera	1.730648	98.77024

Source: Calculated from the data taken from BSE official Website for the selected period.

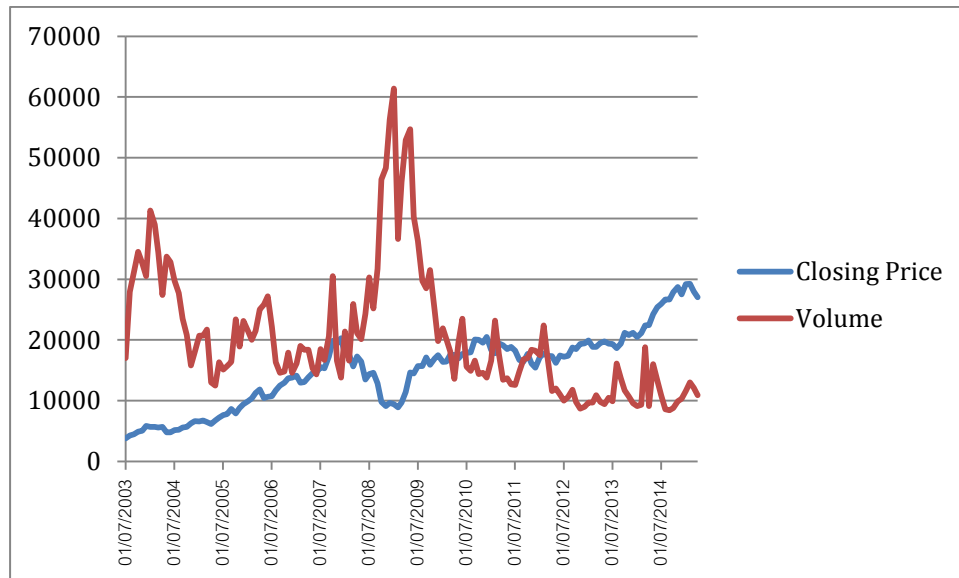
**Note:**

- Skewness is a measure of asymmetry of the distribution of the time series around its mean.
- Kurtosis measures the peakedness or flatness of the distribution of the series.
- Jarque-Bera test is a goodness-of-fit test of whether sample data have the skewness and kurtosis matching a normal distribution.
- ARCH-LM test statistics is the Lagrange Multiplier test statistic for the presence of ARCH. Under the null hypothesis of no heteroskedasticity, it is distributed as a chi-square.

Descriptive statistics on Bombay Stock Exchange's Price and Volume are summarised in the Table 1 above. The skewness statistics for price and Volume are found to be different from zero indicating that the return distribution is not symmetric, but for the later it is more asymmetry in comparison to former. Furthermore, the relatively large excess kurtosis suggests that the underlying data are leptokurtic or heavily tailed, and sharply peaked

about the mean when compared with the normal distribution, which is more in case of Volume as compared to Price. The Jarque-Bera statistics calculated to test the null hypothesis of normality rejects the normality assumption. The results confirm the well-known fact that, Closing Prices are not normally distributed but are leptokurtic and skewed. The results of the current study are similar to that of Ou and Wang (2011), where they remarked that, their facts suggest a highly competitive and volatile market. To sum up, the analysis indicates that, the Closing Price and Volume of the Indian Stock Market are non-normal, and exhibits volatility.

**Figure 1: The trend of Stock Price and Volume for BSE in India**



Source: Based on the data taken from BSE India website for the selected period.

Descriptive investigation of the plot of Closing Price and Volume of Bombay Stock Exchange (figure 1) reveals that, the Closing Price continuously fluctuated around the mean value that was close to zero. In comparison to Closing Price, Volume volatility is more; but initially the former volatility was less as depicted from figures. From the time series graph of the returns for both Closing Price and Volume, it is analysed that high volatility are followed by high volatility and like low volatility are followed by low volatility. That means time series have important time varying variances. Additionally, it is appropriate to put conditional variance into the function to clarify the impact of risk on the returns.

The presence of unit root in a time series is tested with the help of Augmented Dickey-Fuller Test. It tests for a unit root in the univariate representation of time series. For a return series  $y_t$ , the ADF test consists of a regression of the first difference of the series against the series lagged  $t$  times as follows:

$$\Delta y_t = \alpha + \beta t + \gamma y_{t-1} + \delta_1 \Delta y_{t-1} + \dots + \delta_{p-1} \Delta y_{t-p+1} + \varepsilon_t,$$

Where,  $\alpha$  is a constant,  $\beta$  the coefficient on a time trend and  $p$  the lag order of the autoregressive process. Imposing the constraints  $\alpha = 0$  and  $\beta = 0$  corresponds to modelling a random walk and using the constraint  $\beta = 0$  corresponds to modelling a random walk with a



drift. The null hypothesis is  $H_0: \delta = 0$  and  $H_1: \delta < 1$ . The acceptance of null hypothesis implies non-stationarity.

**Table 2: Unit Root Testing of Daily Returns**

	Closing Price		Volume	
	t-Statistic	Prob.	t-Statistic	Prob.
<b>Augmented Dickey-Fuller (ADF) test statistic</b>	-11.6054	0.0001	-10.8376	0.0001
<b>Test critical values:</b>	1% level	-3.47748	-3.47783	
	5% level	-2.88212	-2.88227	
	10% level	-2.57782	-2.57791	

Source: Calculated from the data taken from BSE website for the selected period.

Augmented Dickey-Fuller (ADF) test to check the unit root problem of data, where the result tends to reject the null hypothesis as the test result gives less than 5% probability and it is also tested in the other way that test statistics are more than the Critical value at their first difference. So finally all data are stationary for all the variables of Bombay Stock exchange.

The preceding analysis helps to make the point that the series, Closing Price and Volume are non-stationary which means that each series individually contains unit root. But, the questions is, either these series share a common trend, so that the gap will not grow without bound. Therefore, I have further conducted an alternative analysis by using the co-integration techniques. The notion of co-integration among variables has introduced a new flexibility into the modelling of economic time series. As defined by Engle and Granger (1987), two variables are cointegrated of order (1, 1), if each variable individually is stationary in first differences (integrated of order 1), but linear combination of the variables is stationary in level (integrated of order 0). More generally, a set of variables is co-integrated of order (d, b) if each variable individually is integrated of order d, but at least one linear combination exists which is of order (d-b). Most of the researchers focuses on the case  $d = 1$  and  $b = 1$  and I have done the same here.

**Table 3: Result of Co-integration Test**

No. of Cointegrating equation (s)	Trace Statistics			Max-Eigen Value Statistics		
	Trace Statistic	0.05 Critical Value	Prob.	Max-Eigen Statistic	0.05 Critical Value	Prob.
None	6.934991	15.49471	0.5852	6.142552	14.2646	0.595
At most 1	0.792439	3.841466	0.3734	0.792439	3.841466	0.3734

Sources: Calculated from the data taken from BSE website for the selected period.

Like Trace Statistic and Max-Eigen Statistic of co integration test to check the long run relationship for both stock price and Volume give the result at 4 lags for both the statistics respectively, which conclude the existence of no long run relationship.

In order to investigate the causal directions associated with the change of Closing Price and Volume, the Granger causality test is applied. The Granger Causality test is used here.

**Table 4: Granger Causality Test**

<b>Null Hypothesis:</b>	<b>F-Statistic</b>	<b>Prob.</b>
<b>Volume does not Granger Cause Closing Price</b>	1.3064	0.2711
<b>Closing Price does not Granger Cause Volume</b>	3.6588	0.0074

Sources: Calculated from the data taken from BSE website for the selected period.

The findings lend a support of unidirectional relationship from Closing price to volume. The casual direction for higher lag values has been investigated but, there is no causal relationship from Volume to Closing Price for higher lag values that is why the test results are not reported for higher lag values. Akaike Information Criteria (AIC) has been used to detect the number of lags, which is resulted to 4 lags for the minimum AIC value of 36.465, because the time series (April 2000 to March 2015) follows a repeating pattern 4 years period.

## **7. POLICY IMPLICATION AND CONCLUSION**

Development strategy is a dynamic process and every country fosters financial development through uses of growth of its financial intermediaries like banks, insurance, stock market and changes in government law, rules, policies, openness to adapt positive changes beyond political maligns and narrowness. In the last few decades, many economies have adopted development strategies that prioritize the modernization of their financial systems. The country India has no exception. However, the effectiveness of such policies requires a convenient causal relationship between financial and real sectors.

The estimated results confirmed that the dataset for Indian Stock Market are stationary and hence, they are integrated. Similarly, the existence of co-integration among the stationary variables by using Johansen co-integration test declared that there is one co-integration and hence, confirmed the existence of long run equilibrium relationship between Stock Price and Volume. The findings also lend a support of bidirectional relationship from Stock Price to Volume. The study may be enhanced further by considering the policy changes that have occurred in India over the last decades. So, there by structural break may also be considered between the periods. So it can be concluded that Indian Stock Market's Volume and Price are dependent and Volume influenced by it's closing price.

No method of valuation can provide investors with an all-purpose tool. A presentation of the value position of the general market or a tabulation of appraisals of a comprehensive list of individual stocks can offer insight into relative values. It should be stressed that values

are neither permanent nor "true". In the investment universe there exist no immutable constant values. In the writings it is avoided even the term "intrinsic" values. Investment values must undergo frequent adjustments reflecting changes in actual and projected earnings. But even such moving, living values cannot help in forecasting the timing of the reversals of the trends of stock prices.

The final warning is that this study is not a "system" too "beat the market" but an analysis, designed to be helpful when used in conjunction with other studies.

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# **THE DIFFICULTIES, TRENDS AND COUNTERMEASURES: THE REFORM OF CIVIL SERVANT PERFORMANCE MANAGEMENT IN CHINA**

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## **ABSTRACT**

As a developing country, China is confronted with a significant historic moment that the economy model has changed from traditional planned to market. Meanwhile, the reformation of human resource performance management (HRPM) model of government has to go through a long process undoubtedly. There is an obviously difference at the model of Human Resource Management (HRM) of government between China and the Western countries. China's model, under influence of the social factors of different historical periods of China, associates with the political institution, economic institution and culture tradition. The model has great significance to enhance the HRPM of Chinese government. Therefore, it is the logical starting point to investigate the reformation of HRPM model of service oriented government (SOG) and the objective requirement to research on the model systematically, by further analyzing the matter and its reason of current model to propose the new trends of the reformation of HRPM model of service oriented government scientifically that based on the systemic disposal data of traditional HRPM model of Chinese government.

Keywords: service oriented government, civil servant performance management, reformation

# THE DIFFICULTIES, TRENDS AND COUNTERMEASURES: THE REFORM OF CIVIL SERVANT PERFORMANCE MANAGEMENT IN CHINA

## 1. INTRODUCTION

Since the beginning of the 21st century, the Chinese government has achieved three changes by the administrative reform: first, the market economic management system has been establishment; the second is the government has turned to the service-oriented, focusing on social management and service quality; the last is management levels of government, management ability, quality and ability of civil servants have been greatly improved. Nowadays, with further development of China's administrative reform, the Chinese government's human resources departments and managers have recognized that the effective management of government employees is a core task of government reform, and from 2013, a number of civil service reform policies and practices are worked up.

The performance management of civil service of Chinese government had been through three stages. The first stage is the Practice starting stage from 1980s to 1990s, which is featured with extensive department assessment. At that time, organizational performance had not become the administrative concept of government departments and the purpose of evaluation to departments was about whether the task had been finished or not. There were no fixed evaluation model and evaluation index, and evaluation practice had great randomness. The second stage is the Explore practice from early to the late 1990's. At that time some government performance evaluation models had established and used. But it was provided only as the link of the performance evaluation in management mechanism. Many government agencies and institutions began to use the social service commitment system, performance monitoring, including the target responsibility system. The third stage is Practice perfect from the end of 1990's to nowadays. In this stage, performance assessment as an effective tool for management had been accepted by most government departments. Experience and practice of government performance management from the western countries' had been introduced to Chinese government, and some of the local governments and departments began to use those theories into the management system of departments and to explore construction of performance evaluation system.

The recent 30 years have witnessed dramatic improvement in the performance management of civil service in Chinese government. However, due to the differences about political system and government operation environment between China and western countries, the local governments and local authorities of China have suffered great pressure from the upper level governments. The authority of the local government is delegated from the higher authority, whose administrative orders should be followed by local governments. At the same time, the local government should meet the requirements about public service from social public. Therefore, the civil service performance management in the Chinese government faces various difficulties and troubles. So the purposes of this research are to solve the following problems. ***The first is how to solve the value oriented problems of Chinese government civil service performance management.*** In practice, some local governments and departments consider the civil service performance management more as a "rating", "assessment appraised" evaluation tools, and think the performance management could not find any problems to improve the efficacy in management, which has negative influence on the psychology to civil service, and easily leads to the distortion of the object's motive and

behavior. Therefore, this paper hopes to, through research, provide some suggestions how Chinese government can improve the function of civil servant performance management, further improve strategy execution, promote the effective tool of internal management level, improve service quality and guide citizens to participate in. *The second is how to change the situation that focuses on results and ignores the process in civil servant performance management.* Since the target responsibility management was the first system used in the civil servant performance management in Chinese government, more concerns are focused on the results but not the process. But in fact, it is very difficult to value public services by quantitative index, and the environmental factors also have some impact to the result of evaluation, in addition, Chinese government has the lack of standardized management in the evaluation, so in the absence of process control, the authenticity of the results tends to have more problems. *The third is how to improve the effectiveness of technology in the civil service performance management.* The performance evaluation technology is one of the important factors which determine the performance evaluation effect, and also the difficult question in performance appraisal. There were so many subjective qualitative factors in the civil service performance management some years ago in Chinese government. With the popular of quantitative methods, more and more local governments and departments enjoyed using them, however, another extreme emerges, that is, excessive emphasis on quantitative and drop in the "digital trap". In practice, the quantitative method and qualitative method should be combined, instead of separating from each other.

## 2. LITERATURE REVIEW

### 2.1 Scholars' viewpoint

The studies about governments' civil servant performance management are mainly form the aspect of citizens' participation and especially after 1990s, the study and practice to promote governments' civil servant performance management to meet the needs of citizen has been paid close attention by western experts and scholars. However, this study mainly focuses on the viewpoints of Chinese scholars. Though the early reform of China adopted and borrowed some theories and experiences from western public human resource management to some degree, with the gradual growth of China's local management culture and renaissance of the Confucius, and the re-emphasis on thoughts, theories and practices of traditional Chinese government and public management, the adaptability of western theories into China is questioned by the academic field and the departments as well. This is mainly because of the features of China's politics, the characteristics of Chinese administrative management system and the complexity of China's civil servants structure, which are quite different from western system.

Concerning the studies of the relationship of governments' civil service performance management and SOG construction, Xiaoping (2008) pointed out performance management was considered as the important instrument in government administrative management reform, and as the driving force to government function change and SOG construction. Guofu (2007) argued that government civil service performance management was beneficial to local government putting forward the new concept of service-oriented and proceeding system creation, while performance management reform was the main breakthrough and basic requirement for SOG construction. As for the research achievements of structure and implementation of SOGs' civil service performance management system, Guofu (2004) argued that the value orientation of local governments' performance evaluation was the



integration of target and instrument orientations and the implementation of performance evaluative result was one the most important part in local performance evaluative process and critical premise to achieve the establishment of new evaluative system and to keep up with the time. Zhiren (2007) argued that public opinion played particularly an important role in performance evaluation to push forward the transformation of regulative government to service-oriented. And Jiannan (2005) thought the core of SOGs was serving the public needs, so the improvement of governments' civil service performance should emphasize service quality, cost and improvement of customers' satisfaction. Jiang (2006) also stated that SOGs' civil service performance evaluation should adhere to the base of positioning governments' function accurately, with meeting public needs as value orientation, and adhere to scientific development and people orientation, to the principle of public and third party as evaluators.

The civil servants' performance management exists in all the procedures of government administration, so various problems can be found in the implementation. Jianfeng and Zheng (2003) states the problems are disconnected to organizational strategy, index either too complicated or too simple, and inefficient performance communication. While Guangming (2005) believes that the two main problems are unclear responsibility and complicated workflow. Xiaoguang (2006) points out that customer oriented civil servants' performance evaluation system—service oriented government—has not come into shape and the main subject of civil servants performance evaluation, criteria and index cannot adapt to the requirements of service oriented government construction. Ningsheng (2006) discusses the cultivation and promotion of China's civil servants performance management systematically and states the development of HRPM should have sound social management basis and at the same time should integrate with government reformation. Guoxian (2007) agrees that civil servants performance management is not only the scientific instrument and efficient tool to accelerate administrative management system reform, but also the main content of the reform. Lihui (2003) argues that government HRPM is beneficial for China's transformation from management and control model to service oriented model. Shuigen and Lingling (2007) point out that civil servants' performance management is one of the standards for construction of service oriented government. A responsible government should serve the people and performance management is one of the requisites. Yongliang and Jinqiu (2006) state that the studies on measurement and evaluation of government HRPM are beneficial for the improvement of work efficiency, service methods, fundamental change of government functions, and for the improvement of service quality. Guofu (2005 & 2007) proposes that government HRPM is beneficial for gradual withstanding of service oriented government concept, and for creation of new system and HRPM is the main breakthrough and basic requirement of service oriented government construction. Naikang (2004) argues that the actualization of civil servants' performance evaluation system should contain target system, comparison system, measurement system and feedback system, which is mainly comprised of information and data collection, performance target confirmation and evaluation project division. Lihui (2002 & 2002) proposes that government performance evaluation should contain information collection, evaluation target confirmation, evaluation project division, performance measurement, and evaluation result application.

As for the present situation and existing problems of civil servants' performance evaluation, Shuigen and Lingling (2007) believe that China's evaluation is lack of subordinate institutionalization, the evaluation procedure is lack of assurance, and supervision mechanism is not complete. Zaisheng (2006) argues that the factors influencing evaluation are unclear job target, ambiguous evaluation standards with strong subjective, and disconnection of evaluation results and individual promotion and salary. Because the present

one has weak positive guidance, Yanhong (2006) states that the scientific evaluation method and normalized program are needed in China's civil servants performance evaluation. Guoxian (2007) points out problems exist in China's civil servants' performance evaluation results, such as random evaluation, insufficient systematic assurance, single evaluation results application, ineffective performance management methods, formalization of results application, and insufficient supporting measures, for example open information and incentives.

For the reasons of China's civil servants' evaluation dilemma and disturbance, Zhiren (2000, 2006, 2008 & 2009) points out four main reasons, the first is disconnection of civil servants' job description and evaluation, that is the present job description cannot cover all responsible areas; the second is China's western and eastern area difference, making the performance evaluation standards inaccurately cover all areas of China; the third is lack of rules and random implementation of rules, making incentives ineffective, and even conflicting psychology towards evaluation due to insufficient evaluation procedure transparency; the fourth is not enough emphasis on performance evaluation and value, making disconnection of evaluation and HR management. While Shuigen (2007) discusses three hindrance reasons of evaluation institutionalization: the first is limitation of present government performance evaluation techniques which comes from enterprise performance management, however, the public service department serves the public, and evaluation indicators are not easy to be put into quantization, and the performance management only develops shortly in China, therefore, the relative theories and practices are not sufficient in China's evaluation; the second is the resistance of bureaucracy who has already benefited from the present evaluation system and who will resist or operate performance evaluation, and even paralyze the system; the third is the influence from traditional culture and idea which take the concept of "rule by man" as beneficial for harmonious organization, which make the scientific evaluation standard being replaced by people's relationships, and which honor government standard power concept, making evaluation a method for the superior to control the subordinates. Zhang Yanhong (2006) believes that the existing problems are caused by subjective and objective factors, while the former includes government's resistance towards performance evaluation mechanism and differentiation towards performance management cognition, and the latter includes unclear definition of public departments' job functions, complexity in performance measurement, incomplete rules of performance evaluation, and weak performance management atmosphere. Suggestion are also offered Guoxian (2005 & 2007) for China's civil servants' performance evaluation, the first is to create beneficial atmosphere for the implementation of performance management, withholding the concept of the people's satisfaction as value orientation, and generalization of performance evaluation as the content of administration reformation, and in the end the performance evaluation system will be constructed and people will be normalized toward reformation; the second is the establishment of scientific and effective evaluation indicators, analysis of civil servants' job position, combination of quantitative and qualitative indicators and avoidance of repetition of indicators; the third is active usage of evaluation results, establishing effective feedback mechanism, connecting evaluation results and interests of evaluated objects, and making the civil servants being evaluated voluntarily being guided by evaluation indicators and completing organization target.

## **2.2 A theoretical analysis of the management policies of civil servants in China**

"Civil Service Law of the People's Republic of China" is an act proposed to appraise the public services' ability including virtue, capability, attendance, performance and integrity

thoroughly by different levels of management authority, especially to evaluate actual performance, came into force and defined the evaluation very clearly on January 1<sup>st</sup>, 2006. “Examination Requirement of Public Service— Trial implementation”, published by Organization Department of the Communist Party of China Central Committee and Ministry of Human Resources and Social Security on January 4<sup>th</sup>, 2007, ruled the basic principles, contents, criteria, processes, results’ application and other relevant of the Civil Examination. From then on, governments at all level refining the mechanism of civil examination continuously. But there are still several issues on the processes of Chinese civil servants’ performance management both in theoretical investigation and concrete practice.

There is some consensus of Chinese scholar to the development of civil service performance management of Chinese government department; the scholars agree that there are several issues have hampered the development of governments’ civil service performance management. The objective of performance assessment is obscure and should be clearly classified; the content of performance assessment is lack of quantitative criteria; the executive of performance assessment is incomplete; the supervised mechanism of performance assessment is imperfect; and the executors’ professional quality of performance assessment is insufficient.

After analysis of causes to the dilemma and obstruction to all the issues above about the civil service performance management of Chinese government, Chinese scholars agree that the following factors lead to the troubles mentioned above: the deviation of idea about performance management, the inappropriate classification of civil servants posts, ineffective implementation of position analysis, and invalid application of performance assessment.

About countermeasures for improvement, some solutions were proposed after the empirical analysis and theoretical research to the issues which had blocked the development of civil service performance management of Chinese government, such as establishment of the appropriate concepts of performance assessment, reasonable classification of the government civil service and accurate description of positions, scientific evaluation index, sound evaluation feedback and oversight mechanisms and reinforcement of practical application of evaluation results.

In summary, a relatively similar cognition is reached in each segment and aspect of assessment, and in the issues, causes and countermeasures of civil servants’ performance assessment. In specific studies, comparative study and documentary study methods are adopted by Chinese scholars to study the theory and practice of Chinese civil servants’ performance assessment, at the same time, problems caused by objective limitations appear in the researches. For example, some researches directly copy foreign experiences without consideration of Chinese conditions; some university researchers do not have relevant practical experience, while government officials who have abundant practice and experience should be introduced into the research process; most of countermeasures aiming to improve performance assessment are theoretical, more recommendations on specific practice should be explored; the perspective of research is relatively rigid, and innovation is needed in theoretical investigation and approach of study. In present researches of Chinese civil servant performance assessment, scholars merely set foot in the domain of specific practical investigation. Considering the previous situation, researches should make contribution, break the thinking pattern and deepen the reform of Chinese civil servants’ performance management.

### **2.3 Definition of SOGs' civil service performance management**

SOG civil servant performance management is based on value management. How to make the staff in governments work more effectively is the major concern of SOGs' HRM. The target of civil servant performance management should be designed on the base of analyzing social needs. Evaluative index should be adopted to assess the results and relevant influence of personal performance in governments, grading performance level, proposing performance improvement plan and promoting performance according to evaluative results.

Based on the above analysis, this study states: SOGs' civil servant performance management based on value management is with the maximization of human resource as premise, value management concept as organizational common belief; human resource managers, playing the role of value managers, analyze departments' performance plan and target, and with support of performance resource to value-added business in value driving factors, finally optimization of inner departments' civil servant performance and personal value maximization can be acquired, and eventually effectiveness of outer administrative behavior and performance can be achieved.

In this pattern, the starting point and elementary are to make sure the performance target under the guidance of value concept, recreate business process and performance resource allocation management; the main content is to establish a set of evaluation index, performance standard and calculating methods which can reflect administrative function; and the core is to establish the application mechanism of evaluation results.

Performance managers in SOGs civil servant are combination of professional personnel specialized in performance management in human resource department and heads of different departments, who can support each other to achieve effective civil servant performance management. The main responsibilities of professional personnel are: program design of performance management, management technique service, evaluation method development, monitoring/evaluating activity, heads of departments assisting and activities organizing; and the heads of departments are executors and practitioners of performance management.

Different from traditional regulative government, SOG civil servant performance managers should pay more attention to achieve the value of civil servants who clearly understand HRPM, stimulate personal value creation through performance management and make sure value achievement of all human resource through various scientific mechanisms operation. Therefore, as value managers, different management patterns should be adopted, and they should not care external performance change or evaluative results, but SOGs providing sustainable excellent service for the public and promoting core ability of civil servants. Thus, creating value concept in SOGs is critical for value managers.

## **3. DESCRIPTION AND SITUATION ANALYSIS OF CHINESE CIVIL SERVANT PERFORMANCE MANAGEMENT MODEL**

Based on the study of management models about current civil servant performance management of Chinese government, material and data collection, the classifications of present HRPMs of Chinese government are described, and the problems about present models are analyzed, finding the key obstacles to the development of HRM of Chinese

government.

### **3.1 Analysis of Classification of Current civil servant Performance Management Model of Chinese Government**

Since in the 1990, researchers began to introduce the experience of foreign governments' civil servant performance management. Some of Chinese local governments had started to draw lessons from the Western countries' theory and associated with local actual situations, in the purpose to discover the pattern and to reform the model. In the effort, some government civil servant performance management models with different features had emerged, such as Qingdao's model, Shenzhen's model, Gansu's model. The categories of current Chinese government HRM models are listed in the following.

#### **3.1.1 Top to Down Model of Behavioral Objectives within Government**

This model is based on the evaluation of top-down processing human resource performance, thus can promote the inter government to manage their civil servant according to the superior key performance indicators, government performance management targets and performance outcomes. It can be classified to four patterns: First is the general government civil servant performance management; second is the civil servant performance management of different industries, such as tax department, police department and business management department; the third is special civil servant performance management; and the last is civil servant performance management based on the institution of civil service quarterly assessment and annual assessment evaluation.

#### **3.1.2 Bottom to Up Model of Public Participation in Organized**

This model, which includes public discussion institution, organizers within government and professional climate appraisal, is the government civil service performance management model with the feature of public participation guide. The essence of this model can bring democratic participation of the public rights into full play, thus can help to put the governmental performance and the performance management of organizers within government under public scrutiny.

#### **3.1.3 Independent Third Party Model on a Particular Significance**

This model requires external independent academic institution to intervene and to evaluate the work results of individual and department with government to some extent, as to overcome the limitations that government civil service performance management is apt to be affected by the administrative objective and performance goal.

### **3.2 Analysis of Current Model's Issues in Chinese government**

In the period of government transformation, the governments change from the traditional all-rounder and executive government to the modern finite and decision-making government. Some Chinese local governments draw lessons from the advanced international theory of government civil service performance management.

The governments explored the practice of management thoroughly and deeply according to their own actual situations, providing a positive role to promote the reformation of civil service performance management of SOG. However, the current models of government civil service performance management has been influenced by the objective conditions that the traditional political culture and administration system grow out of Chinese long-term history with various problems.

### 3.2.1 The Design of Objectives is Unreasonable and it is Difficult to Quantitative

The objectives of government civil service performance management are attaining the goal of government civil service performance, and promoting and realizing the value of individual within government. However, the fundamental problem of present performance management of governments is too much concentration on the goals of government organizational performance which ignores the potential exploration and individual value achievement in human resource. Therefore, two aspects of dilemma arise: the individual value promotion and realization of government human resource, and the operational difficulties of the design and practice of the indicator system of government civil service performance evaluation.

#### *The Objectives for civil service performance by law in China*

*NO 4. The civil service examination, taking the civil service's position responsibility and the work duty as the basic basis, include Morality, ability, diligence, achievement, and honesty.*

*Morality, is the ideological and political qualities and personal character, professional ethics, social morality and so on.*

*Ability, To refer to duties of the professional quality and capacity.*

*Diligence, is the sense of responsibility, work attitude, and work style.*

*Achievement, the completion of the work of the quantity, quality, efficiency and the benefits.*

*Honesty, is the honesty and self-discipline, and so on.*

*NO5. The civil service examination is divided into normal examination and regular test. Usually examination focuses on assessing the civil service to complete day-to-day tasks, the stage of the goal, and work on time. It can be taken by writing working summary, the special inspection, and attendance, etc. But the ultimate level decides by the direct leader.*

### 3.2.2 The Government Emphasizes Too Much on External Management and Ignores the Organically

At present, the government civil service performance management model emphasize too much on the production of government administrative action and the goal attained of government administration, focusing on the consistency between government administrative production and the government administrative goal, thus neglecting the organically management of government human resource, leading to the under exploitation of the inherent potential of human resources and lacking of activity and creativity. Therefore, the matters above hinder the sustainable development of human resource and the efficient operation of government fundamentally. There are two principal aspects: on one hand, the present government civil service performance management ignores the inherent potentials of development and the possibility of high appreciation in human resource by emphasizing the origination of cost idea materialism. Human resource is considered as the element of cost and technology that are similar to material resource, and as a kind of non-capital essential productive factors to put into government performance management. Human resource is not considered as a kind of resource with high value addition and profitability, sustainable development in term of human resource theory. On the other hand, the current government civil service performance management model belongs to executive management which emphasizes the task management of government, and ignores servants' internal needs and individual development, lacking of due respects and performance communication with the servants, thus it is difficult to make anticipatory programming and strategic decision for the

long-term development of government and human resource, moreover this model is apt to cause the waste of human resource, such as separation of staff and affairs, idle talent, blocking of human exploitation.

### 3.2.3 The System of Performance Assessment, Needs to be perfect

The performance assessment doesn't equal to the performance management of government civil servant, and it is different from government performance assessment in the objective, the function and the criteria of assessment. Several local governments of China have started exploration on practice and various performance assessment activities were developed with continuous deepening of the reformation of Chinese administrative management mechanism. But the performance assessment has still in the initial exploratory phase and the local governments' development is not balance with a late starting. Therefore, various problems in current system of performance assessment need urgent perfection. For instance, the subject of assessment is single and the multi-assessment system that the external assessment should be the subject has not been established; the content of assessment is too rigid to form a scientific and rational assessment index system with multi-dimension; the defection of assessment methods and techniques lead to high costs; and the insufficiency utilization of assessment result made the promotion of government human resource performance circulation blocked.

**Tables 1: The civil servant performance by law in China**

Grads	Index	Assessment committee	Method and program	Results use
<b>Excellence</b>	(A) high ideological and political quality (B) Proficient in business, excellent working ability to work (C) a strong responsibility in work, diligence, good work style (D) The outstanding work performance (E) Honest and clean	The assessment committee shall be composed of the leader of the organization, the manager from the civil service management department and representatives	(A) Reporting to the assessment committee (B) According to colleagues, and the usual assessment and personal summary, leaders write a comment, give a grade suggestion (C) Publicity; (D) The	The results of the assessment as a basis for the adjustment of the civil service positions, levels, wages and civil servants, training, dismissal
<b>Competent</b>	(A)good ideological and political quality (B)Familiar with in business, good working ability to work (C)better responsibility in work and work style, positive work (D)Be able to complete own work (E)Honesty and self-discipline			
<b>Basic competence</b>	(A)General ideological and political quality (B) Ability to perform duties is weak (C)Shortcomings in the job responsibility, or work style. (D) Can basically complete own work, but the number of completed work, quality and efficiency is not high, or in the work of a large error (E)Can basically be honest and self-discipline, but some aspects			

	of the problem	of civil servants.	assessment grade determined by the leader or the authorized assessment committee	
<b>Incompetent</b>	(A)The ideological and political quality are poor (B) The quality of service and the ability to work can not meet the requirements of the work (C) Job responsibility or work style is poor (D) Cannot complete the work task, or in the work due to serious mistakes, dereliction of duty caused major losses or adverse social impact; (E) The existence of the problem of corruption, and the situation is more serious.		(E) The assessment results shall be notified to civil service and shall be signed by the civil servants themselves	

### 3.2.4 The Poor Business Processes Operation and the Blocked Performance Resource Allocation

While a series of practice on the business process reengineering, such as the restructure of central government offices, the province governing the financial management of county which governs the rural county finance, but there are still several issues on the performance resource allocation within the current civil servant performance management in Chinese government. For example, (1) the irrationality of government human resource assignment affects the promotion of administrative action and benefit; (2) the unreasonableness of business process setup makes the running not smoothly; (3) the performance resource assignment has not combined with the governmental administrative action and value activity of business process.

### 3.3 Analysis of the Origin of Current Model's Issues

The issues of current civil servant performance management model are the result from the comprehensive effects of several factors including internal determinants and external influences. On one hand, a series of issues of performance management are caused by the inadequacy of civil servant performance management mechanisms which lead to blocked performance management processes that consist of performance program, execution, assessment and feedback. On the other hand, a system consisting of policy, economy and cultural environment has the influence on the work quality of government apartment servants and the goal value of whole organization, especially the long-term performance value. It is suggested that the social environment is relative stable during a specified time, whereas the course of practice of government performance management is developing. It is significant to promote the reformation of government HRPm model by summing up and analyzing the major cause of current issues from the internal factors of government HRPm. In short, there are four reasons for the problems existing in government HRPm model currently, which are listed below.

#### 3.3.1 It Is Difficult to Define the Value Indicator without the Value Driver

To make sure the potential value driving factors, the logic relation of business should be established, therefore, sustainable factors can be selected accurately and be put into order and further be transformed into value indicators, which is also the important basis for the government human resource performance managers to show their subordinate the way that strategic objective can create value and then to make them identify it. Because of the



government departments at all levels are lack of the scientific cognition and the accurate grasp of the value driver of government HRPM, thus leading to ambiguous performance management objective and unclear performance indicator design, as a consequence the human resource performance managers cannot make the objective assessment and the efficient management to the performance of their subordinate sector, which are shown in the following two aspect: (1) the unclear recognition to the value driver of government HRPM leads to the inadequacy of value driver, which makes it difficult to realize the objective assessment mechanism of value orientation; (2) the obscured distinction between the short-term and long-term performance influencing factors of HRPM of government sectors at all levels leads to unclear value orientation, making it difficult to confirm value indicators.

### **3.3.2 Performance Management Ignores the Working Carrier**

The Chinese government HRPM for a long time ignores the working as a carrier, namely, the management of people and the value management of working practice: (1) an emphasis on high degree of unity of process and result and the internal promotion of individuals' working ability of government sector is ignored; (2) an emphasis on the internal controls of government job and the realization of individual value in government is hindered.

### **3.3.3 The Inconformity of Assessment Criteria Leads to Assessment System Inefficient**

At the moment, the government human resource performance assessment system is being perfected with gradual emphasis and the practice exploration of Chinese local government on the government human resource assessment management. However, it is difficult to make quantitative analysis into the practice due to different standards in assessment criteria, especially in decision making and consultation. At the same time, the goal and administrative output of government human resource performance are complicated with strong subjectivity. So the goal of performance management is not clear and it is hard to define the achievement level of the goal of performance by the output of administrative actions to the level of completion of performance objective, thus leading to inconsistent assessment criteria, inefficient system and formalistic assessment.

The key point is to define the assessment criteria for government HRPM. That is because the structure of assessment criteria system is decided by the criteria and the clarity of criteria can influence the level of difficulty of assessment. Last but not least, the objective and quantifiable of criteria can decide the scientific assessment result and the effectiveness of assessment behavior.

### **3.3.4 The Weak Feedback will Influence the Whole Business Process Reproducing of HRM**

The business process reproducing of HRM is the basis to the promotion of the level and effect of HRM. But the key to manage is to improve the performance program with effective use of the results of performance assessment through performance feedback, and then to realize the rational distribution of performance resource of HRM and the reconfiguration of business processes management through the improvement of performance program.

On one hand, most government human resource performance managers take the management process as the execution of performance program to the achievement of performance objective. They pay too much attention to the static documentation but ignore the actual operation of the management process and the influence of servants' practice to the whole business process, and they also ignore the influence of external environmental factors

to the business process of organization, resulting in ineffective information resource flow to the higher level. Therefore, the performance management cannot be updated and allocated promptly, and the human resource cannot be focused effectively to execute performance management. On the other hand, from the view of government servants--the working carrier of government HRPM, to finish the allocated assignment through individual endeavor under the planned performance and goal of organization is a responsibility. Whereas, as a part of the whole performance management process, the servants should not only be the instrument of performance objective attainment of performance management of organization, but also be the main force to propel the development of performance management process continuously. The government servants should assess their performance objectively according to the demands of performance program and the performance assessment standards. And they should give feedback about the new situations and new problems, good methods and suggestion on effective realization of organizational business flow reproduction. Therefore, the goal and dynamic environment can be kept consistent and effective operation of organization business flow can be assured. However, because the misconception in current performance management ideas and the unsound mechanism of assessment, the government human resource performance managers have not established a set of effective mechanism of information feedback under the ideas of scientific performance management, thus influencing to the information communication and the resource configuration of business processes of government departments. Meanwhile, with the lower competency of the whole government servants, the servants ignore the positive role of self-feedback mechanism to individuals' performance realization and organization structure operation. The two factors above make the feedback mechanism of government HRPM imperfect, and the weak feedback has blocked the whole business process reproduction.

#### **4. THE TREND OF PERFORMANCE MANAGEMENT REFORM OF SOG HRPM**

Great changes occur at the internal and external administrative environment of government in the transformation of Chinese government from traditional control-oriented to modern SOG. At the same time, changes can also be found in the mechanism of HRM of modern SOG. As an important part of government HRM, the government HRPM is the significant instrument of competitiveness promotion of organization to help the servants to advance their ability and individual value. Currently, according to international advanced theories of HRM and in consideration of their status of government HRM, government around the world has established their own model of government HRPM with unique features. To guarantee the performance promotion and the value realization of government human resource, governments persist in the open reform-oriented.

With the improvement and perfection of Chinese servant system and with gradual introduction of modern organization HRPM concepts into SOG HRM system, several issues need to be taken into consideration: such as the way to promote servants' ability by enthusiasm and initiative, the way to make sure the adequate realization of individual value by developing servants' inherent potential, and the way to meet the requirements of government HRPM and further development by improving and perfecting government human resource exploration mechanism and management mechanism. Therefore, it is significant to accelerate the reformation of HRPM model of Chinese modern SOG and control the trend of development.

#### **4.1 Change the View of Performance Management and Establish the Dynamic Development View of HRPM**

Only by changing the traditional notion of HRPM, emphasizing the growth and development of human resource of SOG, and establishing the dynamic development notion of HRPM can a team of human resource of SOG be built up including professional and technical class, executive class and external personnel. The core of HRPM of SOG is to improve the effectiveness and efficiency of government administration, which depends on the improvement of individual capacity and quality of the three-team members. Therefore, the managers should pay more attention to discover the development area of human resource and continuously transform the potential ability to capacity. The managers should also put the available HRPM before team building, team management and team development, organically combining the performance of SOG with the HRPM of SOG. To achieve the reform, the role of human resource managers should be changed, and the capacity of HRPM should be promoted, making the human resource individual and group to obtain the assistance and guidance from their superior, and then realizing mutual cooperation between superior and subordinate who can discovery and analyze the issues together. Therefore the human resource individual and group can solve problems and complete tasks with resource acquired and solve problems and finish tasks independently.

#### **4.2 Transform Single Dimension and Set up Multi-Dimensional HRPM**

The traditional HRPM practices only from the view of manager and conduct management with single view of result assessment. With the development of the SOG, multi-dimension oriented HRPM should be established by government HRPM and three transformations need to be taken into consideration: the transformation from simple objective-oriented to process management; the transformation from result-oriented to development-oriented; and the transformation from single assessment to system assessment.

#### **4.3 Change the Single Subject and Clarify the Diversity of HRPM Subject**

At present, the misunderstanding exists in government HRPM subject. The traditional view suggests that government HRPM is the duty of HR department, because government HRPM is the key component of HRM, which reasonably manages; and because from the view of department member of HRM, they think that it is their duty to manage the human resource. Meanwhile, the enormousness and complexity of government organization and the complexity of each department drive the demand of multi-dimensional subject of government HRPM, thus the inevitable tendency is to restore the truthfulness of the subject of HRPM and to realize the diversification of the subject of management.

This study believes that the subject of HRPM under the reformation of HRPM model of SOG is a diversified management subject with HRM as an organizer and various functional departments as managers. In other words, government HRPM involves the participation of HR department and each functional department, and the management obligation is undertaken by performance management professionals and department managers. The department of HRM and other functional departments realize the practice of HRPM together by interaction with and support from each other. In specific, there are four main obligations for the department of HRM in government HRPM: providing technical support for the functional department to develop HRPM by establish the platform of HRPM; holding the orientation of HRPM by design the program of HRPM; making sure that the management mechanism of selection and appointment operates effectively by formulate the

basic policy of HRPM reasonably; supervising the executive process of performance management and receiving the performance feedback of functional department, and improving performance under the results of performance assessment. As the managers of government HRPM, the departments' managers are also the executor and the practitioner of the development of HRPM. In short, only by combining the macro-control of the department of HRM with micro-control of other departments to HRPM, can the progress of practice of HRM develop go smoothly, and can the model of HRPM of SOG operate effectively.

#### **4.4 Improve the Content of Management and Realize the Scientific of the Content of Human Resource Performance Management**

Different from traditional control-oriented government, the content of HRPM of SOG is becoming more and more scientific. The scientific of content is that the new recognition of the nature of HRPM of SOG is the basis, with the guidance of requirement and value management, and the content system of HRPM can be established scientifically and reasonably.

The new recognition to the nature of government HRPM is a process that it should be recognized that HRPM of SOG is not only the process to calculate and analyze the situation of government member performing in administrative functions and fulfilling the objectives simply, but also the process of value management that the government members create value by the stimulation of performance management with full realization of individual value in essence. And the main responsibility of HR performance managers is to improve the core capacity of government member continuously and to fully realize individual value. In addition, as the final provider of government public service, the value that government servants persist and whether they can better perform their administrative function and complete the objective will relate to the interest of the public. Thus in the process of selection, training and development and assessment of servants, the value orientation, the demands of individual development, public demands and social satisfaction should be adhered to. First, in the selection process of SOG members, besides making scientific recruitment plan and procedure, the value orientation should be taken as a guidance and control and assessment of the whole recruitment with the value of SOG should be implemented. Second, it is necessary to keep the demand-oriented of government individual in the process of training and development of human resource. Last but not least, the orientation of public demands and social satisfaction should be insisted in the assessment of HR performance of SOG.

## **5. ADVICE OF REFORM OF CIVIL SERVANT PERFORMANCE MANAGEMENT IN CHINA**

### **5.1 Integrating value management into planning and investment analysis of department civil servant performance management**

The present traditional governments don't pay enough attention to value creation, however, the primary task of SOGs construction is to build up value concept to serve the social development in everyone's mind. To change the present situation, SOG construction should emphasize that value creation is the primary responsibility of everyone in SOGs, that is, managers in governments and departments of all levels should make value analysis of each work and each post with the help of value management theory.

As SOGs, sustainable administrative ability promotion should not be based on the

measurement of hardware index like GDP, but value creation increase of different departments and governments. However, in practice, problems existing in some governments are: first, paying less attention to human resource—value creators' performance planning and human capital investment, but eagerly asking staff to finish high standard job with present administrative level and ability; second, even if the relative civil servant performance planning has been made, it is only a piece of paper, not closely related to departments' strategy and working plan. The above two problems lead to impossible implementation and evaluation of human resource capital investment expenses under the situation of planning without guidance of practice.

Therefore, planning of SOGs' HRPM should be in accordance with local governments at all levels, should disintegrate strategy target to business level, and point out accurately program design, techniques and skills, practical methods and evaluating index to achieve the target.

## **5.2 Achieving target evaluating system under guidance of value**

Managers of SOGs at all levels need to make accurate performance target and index to measure work development of staff in civil servant performance management. Some outer performances like work capacity and work progress are the basic performance standard, but as value managers, the specific index which can be beneficial for department core ability promotion should be put at the kernel position in civil servant performance management.

The value of governments' departments at all levels is determined by short-term and long-term performance. Therefore, the value driving factors in SOGs' civil servant performance management should be combination of short-term performance of every department and factors related to sustainable development of work. The following points should be followed if SOGs' civil servant performance management wants to clear the value guidance: first, only under clearing understanding of the premise being short-term and long-term performance influencing factors can managers make accurate decision between short-term and long-term sustainable developing performance when one value target pursuit will decrease another performance; only under situation of clear priority of assignment and post responsibility can managers let the work concerning long-term performance and greater value creation have priority.

Two basic steps should be followed when SOGs' civil servant performance managers make value guided target evaluating mechanism. First, logic business should be established to confirm potential value driving factors. During this step, the central work is to analyze the main value of every business with help of value tree, establishing visualized systematic map between administrative ability and return rate of human investment. Second, the highest preference of value driving factors should be confirmed. Because it's hard for department managers to control every factor in term of quantity of value factors which are disintegrated by value tree related to business. Thus managers need to select the key value driving factor of each business, and the most important principle is sustainable development. The factors which can only bring one value should be ignored. When finding the central value driving factors concerning sustainable development, the factors should be ranked and relevant value index should be found.

It is the elementary for SOGs' civil servant performance managers to select and rank key value driving factors accurately and transform them into value index, which can be used to explain how departments' strategic target turns into value to the subordinates who can in turn agree with and support the target. Based on HRM theory, the value driving factors in SOGs' civil servant performance management are mainly from two aspects: sustainable administrative ability and return rate of invested human capital. The former refers to the capacity of governments' staff at all levels in their own posts effectively continuing highly performed administration; the latter refers to the potential developing power of subordinates, besides basic administrative efficiency and benefits, after professional training and investment educating conducted by governments. The above two index are the standard orientation for SOGs' civil servant performance managers when analyzing key value driving factors.

To achieve value target evaluating mechanism, Administrative capacity and increase of return rate should be made according to specific characteristics of every department by SOGs' civil servant performance managers. For example, the department which shoulders the responsibility of social service should emphasize the ability to discover social needs, while inner office should emphasize the ability of coordination or logistics. After deep research, each department manager should set up detailed performance standards according to administrative capacity and return rate. During setting-up process, key abilities and departments' strategic elements should be combined effectively, being central elements for work launching in department.

### **5.3 Establishing value chain performance resource allocation mechanism based on business process reconstruction**

The traditional governments' business process is not combined with work behavior and value activity, lacking of advanced information and technology support or information system with low efficiency which makes traditional governments' civil servant performance management information hard to highly integrate, leading to delayed renew and allocation of performance management, largely influencing the accuracy and efficiency of civil servant performance management.

#### **5.3.1 SOGs' business process reconstruction**

SOGs' civil servant performance management should have business process reconstruction first to achieve performance resource allocation with value chain as the instrument. Due to completeness of business process reconstruction theory, the paper will discuss more about the basic principles being followed when conducting it.

First, SOGs' business process reconstruction should take performance as driving force. SOGs' business process should be a value producing chain to provide service with value which consists of value-added activities and assisted activities. The former one can bring added value of economic and social value, such as economic development and credibility promotion; the latter only consumes resource and doesn't bring value directly. Therefore, with performance management as driving force and under the premise of effective operation of business chain, every link should be recognized and quantized to make sure key resource being allocated to value-added activity, and the redesign of key links should be reinforced to simplify and combine assisted links.

Next, the center of SOGs' business process reconstruction is completeness. The high

performance and benefits of SOGs are not only derived from one link, but the whole business chain. Therefore, human resource allocation should not only cover every link, especially value-added one, but also guarantee effective connection among business in every link, then coordination in business process can be achieved.

Last, the premise of SOGs' business process reconstruction is motional. For SOGs, though working objects and responsibility are fixed, working content and assignment will be changed according to different serving objects, situation and various factors. For example, some old work content will be deleted because of change of law or regulation. Therefore, SOGs' HRPM should be updated or adjusted in motional management business process.

### **5.3.2 Value chain performance resource allocation mechanism of SOGs**

Only when SOGs' business process meets the satisfaction of the above three points can human resource performance resource allocation be prepared in the early period. Then, in the value chain performance resource allocation mechanism based on business process reconstruction, SOGs' allocation mechanism is the organic integration of performance resource management and ERP system integrated module, multidimensional resource investment module and performance resource management cycling module, conducting allocation management to the resources needed in every business link.

Firstly, through integration of performance resource management and ERP system, rapid and accurate performance resource can be established though borrowing information and technology rapid transmission and data processing, data integration and share of ERP system performance resource. At the same time, in ERP system, the integration of resource needed and consumed in performance practical activities can achieve instant control and motional analysis from many angles and management of SOGs' human resource performance practical activities.

Secondly, multidimensional performance resource investment planning module is the basis of reasonable allocation of performance resource. To coordinate with ERP system, this module should be the element, namely, the constructive elements of resource investment should be confirmed. As the center of overall planning management, the concrete representation of multidimensional performance resource investment planning module is resource consumption produced by various value activities in business process. The main resource consuming body is value activity in every business process link; therefore, the effective dimensions adopted in performance resource planning system should be driven by value activities in business process.

The dimension in multidimensional performance resource investment planning module is mainly composed of key value activities, business periods, performance resource consuming measurement and performance resource management responsible center. This module is beneficial for the analysis of various value activities in SOGs' business process, value creative situation, value-added activities discovery and decreasing resource investment of non-value-added activities. This module is also beneficial for the core of resource management responsibility center, understanding of expected business investment and actual investment, achievement of combined management of responsibility, right and benefits, and the control of resource using risks through resource variants.

The coordination of multidimensional performance resource investment planning module and ERP system can achieve harmony of instant management and motional feedback

management of performance resource planning and usage. The data in ERP system records the details of various dimensional elements related to performance value activities, while multidimensional performance resource investment planning module only select partial dimension to describe the nature of planning data according to features of performance activities and management requirements.

Effective analysis in multidimensional performance resource investment planning module should be based on scientific activities. If the planning dimension is far away from real implementation, the value of performance resource investment planning management will be hard to achieve, misleading decisions related to the management practice of SOG' human resource performance.

Thirdly, performance resource management cycling module of service-oriented performance management should insist the principle of "reality, balance and logic". First of all, performance resource management target should be checked whether it can be achieved or not. The performance resource management module should be guided by value orientation, and the management target is also the value target-- disintegration of resource usage in planning periods. Therefore, whether resource management can be real is directly related to the implementation effectiveness of value activities in SOGs' HRPM. Next, the balance of resource capacity of performance activities should be put into consideration.

On one hand, the value activities of SOGs consuming resources, on the other hand, it creates resource. The premise of normal operation of value activities is no short supply of resource, while to acquire maximum value, no resource can be laid aside. Thus the balance of resource capacity is the standard to measure the operation of performance activities and resource utilizing efficiency. Last but not least, whether inner management module can represent the logic of value chain should also be put into consideration. Strong inheritance and cause-and-effect relationship are among value activities. Thus the resource management of different value activities should not be independent, which should represent logical relationship among actual value activities.

## **6. CONCLUSION**

The perfection of SOGs' civil servant performance management system is a procedure from practice to theory conclusion and theory again being guidance of practice. Different systems and viewpoints as point cut and content will appear in performance management reform in China. With value management as basic concept and point cut, performance planning and investment analysis, target evaluation, establishment of performance resource allocation management mechanism under the reform of administrative business process in SOGs' civil servant performance proposed in this paper are theory discussion and research in micro level proposed by the central government of China in the Thirteen Five-Year Strategic Plan (2016—2020) for China.



## **7. LIMITATION**

The study mainly has two limitations, the first is China's governments keep secrets of the management data and information, and effective practical cases cannot be obtained by the researchers to make further analysis. The materials acquired by researchers are articles in the journals, documents of governments, news reports and legal documents; the second is that the complexity of China's governments' management culture and the complexity of China's civil servants system are not effectively described in this study.

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# **RISK ASSESSMENT OF NON-PERFORMING LOANS (NPL) USING EXTREME VALUE THEORY**

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## **ABSTRACT**

This paper answers two research questions: what is the appropriate modeling tool for NPL study? and whether the NPL rates in Thailand show improving or deteriorating trend? NPL is of interests to management decision makers because it serves as an indicator for assessing risk in commercial loans. The methodologies employed in this research are system analysis under Extreme Value Theory (EVT) and relevant tests suggested by the Tail index. Conventional time series models, such as AR, MA, ARIMA and ARIMAV are not adequate to deal with short term risk assessment due to restrictive assumptions in autoregressive modeling and the requirement of longer observation period. This research fills the gap in the literature left by conventional time series modeling. NPL data of ten industries in Thailand for a period of eight operating quarters from 2013 to 2014 were used. It was found that there are two types of distribution among NPL rates. Eight industries are distributed Weibull and two industries are distributed Fréchet. This finding further reinforces the use of EVT as an appropriate modeling tool for NPL studies. Under EVT, it was found that the risk threshold for Thailand's NPL is 10.91 where three industries showing NPL near or beyond this threshold. The proposed method of NPL analysis in this paper provides a practical tool for decision makers in NPL management.

Keywords: Risk assessment, Non-Performing Loans, Extreme Value Theory

# RISK ASSESSMENT OF NON-PERFORMING LOANS (NPL) USING EXTREME VALUE THEORY

## 1. INTRODUCTION

This paper is a study of non-performing Loans (NPL) in Thailand between 2013 and 2014 under system failure analysis. The objective of this paper is to contrast the model efficacy between time series method and system failure analysis approach. The current literature looks at the cause and effect of NPL, but there is a lack of literature looking at NPL as a closed system or process. This gap in the literature motivates this research. Thailand is used as a case study.

This paper presents two research questions: (i) what is the appropriate modeling tool for NPL study? and (ii) whether the NPL rates in Thailand show improving or deteriorating trend? The answer to the first questions helps NPL researcher to effectively analyze and forecast NPL. The answer to the second question has a practical implication because it would help managers and policy makers to tackle NPL problems.

The objective of this research is to study NPL as a closed system. To that end, the research does not look into the cause and effect of NPL. This research focuses on NPL's latent condition through the use of Generalized Extreme Value (GEV) analysis in order to gain a better understanding of the behavior of NPL in 10 industries in Thailand.

The intended contribution of this research is to provide an alternative tool to time series modeling in the context of studying commercial loans defaults. By verifying time-to-event data trend through nonparametric test, system failure could be evaluated for effective risk management. The practical value of this research lies in its ability to assess short-term system risk.

The data used in this research came from Bank of Thailand's NPL records. The data consists of NPL percentage total of commercial loans from eight operating quarters for fiscal years 2013 to 2014. The data is censored from a definite beginning time  $t_0:2013$  and terminated at  $t_c:2014$  (Tableman & Kim, p. 9). The sample used in this research was obtained through non-probability sampling. Since the data is interval censored, it is not possible to affect random sampling (Sampath, 2005). The data set for the 8 operating quarters within the interval of Q1/2013 through Q4/2014 was used.

**Table 1: Non-Performing Loans Classified by Industries in Thailand**

Industry ID*	FY 2013				FY 2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	1.50	1.46	1.59	1.52	1.52	1.45	1.35	1.33
2	0.20	0.18	0.21	0.17	0.16	0.18	0.17	0.17
3	34.25	32.32	30.70	29.42	29.03	27.46	26.69	27.26
4	3.97	3.83	3.87	3.84	3.93	3.79	3.51	3.42
5	14.25	14.48	14.69	15.34	14.70	15.37	16.34	17.58

6	0.34	0.42	0.30	0.26	0.25	0.24	0.25	0.27
7	9.75	9.12	9.34	9.15	9.09	10.17	9.69	9.06
8	2.15	3.92	3.83	4.21	4.30	4.22	3.55	2.62
9	10.05	10.32	9.78	8.94	8.60	8.31	7.79	8.00
10	23.52	23.93	25.68	26.89	28.18	28.81	30.66	30.03
11	0.02	0.02	0.01	0.01	0.00	0.00	0.00	0.00
*Industries: 1. Agriculture, 2. Mining; 3. Manufacturing; 4. Construction; 5. Wholesales; 6. Finances; 7. Realty; 8. Public Utilities; 9. Services; 10. Personal Consumption, and 11. Others. In subsequent tables, item 11 will be removed due to lack of data. Source: Bank of Thailand (2015).								

## 2. LITERATURE REVIEW

Non-Performing Loans are loans that are in default or close to becoming default. The IMF defines Non-Performing Loan (NPL) as:

“A loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons—such as a debtor filing for bankruptcy—to doubt that payments will be made in full” (IMF’s Compilation Guide on Financial Soundness Indicators, 2004).

According to the IMF’s definition, NPL is a microeconomic event that happens between lender and borrower at the transactional level. However, studies have shown that NPL carries macroeconomic effects. Hu (2014) demonstrated that NPL hinders macroeconomic growth and reduces economic efficiency because NPL exposes the system to financial vulnerability (Kemraj & Pasha, 2009).

The NPL literature focuses on the causality of NPL and policy recommendations to tackle NPL issue. To that end, NPL literature had been classified into three strains by Nkusu, (2011). The first line of literature looks at NPL in financial institutions and the role of NPL in macroeconomic performance. Under this argument, since NPL affects macroeconomic performance, state intervention in form of policy choice is recommended (Dash & Kabra, 2010; Espinoza & Prasad, 2010; Louzis et al., 2010). This first line of literature may be called the Macroeconomic Effects of NPL Literature.

The second line of literature looks at the utility of NPL as a condition that could predict banking crisis, and hence, NPL may foretell structural weakening of the financial or credit institutions (Caprio & Kling, 1996 ;Kaminsky & Reinhart, 1999). This second line of literature may be called the Utility of NPL Literature.

The third line of literature looks at NPL at a national level and assesses how does a national level of NPL relates to the economy. This approach differs from the first line of literature in that it focuses on NPL as a cause whereas the first line of literature looks at the effect of NPL (Rinaldi & Sandis-Arellano, 2006; Pesola, 2007; Japelli et al., 2008). It differs from the second line of literature by looking at the relationship between NPL and the economy at a macro-level whereas the second line of literature looks at NPL at an industry

level. These three lines of literature may be classified as cause and effect studies (Beck et al., 2013).

This research does not follow any one of the three lines of literature. The current literature does not have studies that would look at NPL as a closed system without looking at causes and effects. This research focuses on NPL as a system and studies its characteristics or underlying conditions through statistical tools: hazard and survival functions. The rationale for studying NPL in this manner is to produce a more practical forecast tool for NPL analysis. It is asserted that with in-depth understanding of NPL as a system, policy makers could put forth effective intervention tools. To that end, the proposed forecast tools in this research rely heavily on small set of time-to-event data. The forecast horizon proposed by this study is for short-term planning.

There are two aspects that this paper differs from existing literature. Firstly, the proposed model for financial distress analysis is non-parametric. Secondly, this paper does not aim at studying the cause and effect of financial distress at a firm level. This paper offers an industry level analysis of patterns of NPL.

Prior studies in time series analysis employed structural equation (Maggi & Guida, 2009). Structural equation is a statistical model used to test a conceptual or theoretical model (Kaplan, 2000). The equation generally consists of measurement model and regression model combined in one equation (Kline, 2011). This approach is known as parametric studies. Parametric equation expresses the value of one variable (dependent) as the result of the occurrence of another variable (independent) (Thomas et al., 1979). Time series analysis under AR, MA and ARIMA follows this structural form by using the prior period as the independent variable (X) to explain the value of the current period (Y). This approach naturally creates high level of coefficient of determination ( $R^2$ ) leading researchers to believe that the proposed model has high power. To avoid this potential false reading, this paper proposes non-parametric approach as a tool for short-term risk assessment. For this reason, this paper does not use dependent and independent variables in order to explain NPL. It is not the objective of this paper to pursue the cause and effect study of NPL. This paper intends to introduce system analysis tools as an alternative to time series and parametric modeling for studying system failure in short period. In studying NPL rates, the *rates* themselves become the units of analysis. By using system analysis through EVT, there is no need to synthesize a model equipped with dependent and independent variables. A single array of data is adequate to produce a forecast function.

## **2.1 Financial Distress Models are Inadequate for NPL Studies**

Financial distress studies may be classified as bankruptcy prediction studies. These studies are parametric studies using the firm's financial statements as the basis. Three models are exemplary: (i) Altman in 1968 (ii) Springate in 1978, and (iii) CA-Score method developed by Jean Legault at the University of Quebec, Canada in 1987. Subsequent literature repeats these three seminal papers.

The Altman Z-score is a general theoretical framework used for financial distress of a firm. It is used to forecast the probability of a firm's bankruptcy. The formal statement of Altman Z-score is given by:

$$Z = \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 \quad (A)$$

where  $X_1$  = working capital/asset;  $X_2$  = retained earnings/asset;  $X_3$  = EBIT/total assets;  $X_5$  = sales/total assets;  $Z$  = overall index; and  $\beta_i$  = parameter to be estimated (Altman, 1962 & 2000). From the definitions of the terms in the equation, it is clear that the Altman's Z-score has limited use. It could only be applied to firms. In NPL analysis at an industry or national level, the Altman Z-score has no use. The research topic of this paper deals exclusively with industrial level and is intended for policy tool formulation, not individual firm application.

The second method is called the Springate method. It is a simplified version of Altman's Z-score (Springate, 1978). The Springate method is given by:

$$Z = 1.03A + 3.07B + 0.66C + 0.4D \quad (B)$$

where A = Working Capital/Total Assets ; B = Net Profit before Interest and Taxes (NPBIT)/Total Assets; C = Net Profit before Taxes (NPAT)/Current Liabilities and D = Sales/Total Assets. The decision rule states that if  $Z < 0.862$ ; then the firm is classified as "failed." Springate is said to have been able to predict with 83% accuracy.

In 1984, Fulmer introduced a third method (Fulmer, 1984). The Fulmer method uses 9 ratios as the predictive variables. The Fulmer's F index is given by:

$$F = 5.52 X_1 + 0.212 X_2 + 0.073 X_3 + 1.27 X_4 - 0.12 X_5 + 2.335 X_6 + 0.575 X_7 + 1.082 X_8 + 0.894 X_9 - 6.075 \quad (C)$$

where F: total index;  $X_1$ : accumulated profits ratio to total assets;  $X_2$ : the ratio of sales to total assets;  $X_3$ : the ratio of profit before taxation to owners' equity;  $X_4$ : the ratio of operational cash flows to total liabilities;  $X_5$ : the ratio of liability to total assets;  $X_6$ : the ratio of current liability to total assets;  $X_7$ : total logarithm of tangible assets;  $X_8$ : the ratio of flowing capital to total liabilities; and  $X_9$ : the ratio of logarithm before interest and tax to interest cost. The decision rule states that if  $F < 0$ , the company is classified as a bankrupt firm. The Fulmer methods is said to be 98% accurate for forecasting within one year and 81% accurate predicting bankruptcy in more than one year.

Finally, a fourth method for predicting firm bankruptcy is called the CA-Score method developed by Jean Legault of the University of Quebec in Canada (Legault, 1987). The CA-Score method is given by:

$$CA - Score = 4.5913 A + 4.5080 B + 0.3936 C - 2.7616 \quad (D)$$

where, A = Shareholders investment / Total assets B = Earnings before taxes and extraordinary items + Financial expenses / Total assets C = Sales / Total assets. The decision states that if  $CA - Score < -0.03$ ; then the firm is called as "failed." This method produces a reliability rate of 83%.

The financial distress literature is confined to firm level analysis. Industry or national financial distress (Non-Performing Loans) study is sparse. This paper attempts to fill that gap.



It is not the objective of this paper to engage in firm level bankruptcy analysis. While firm analysis is good for corporate managers and investors to assess performance and risk, an industry or national predictive model of financial distress studies would provide policymakers with a clearer picture of the magnitude and direction of NPL. Such information will help plan for corrective measures. The intended contribution of this paper is to provide that practical tool for macro-policy formulation.

## 2.2 Time Series Modeling

There are two main lines of methodology used for time dependent event analysis. The first approach is time series modeling. This method is commonly employed in econometrics (Brockwell & Davis, 2002). The second method, under which this research adopts, is the time-to-event modeling which uses system failure and survival functions analyses (Richards, 2012).

Conventional practice in econometrics relies on autoregressive family of models for sequential time-based event modeling. These time series modeling may be classified into univariate and multivariate models (NIST: Engineering Handbook, 2013). Univariate time series is common; it consists of a family of autoregressive (AR) modeling in the generally form:

$$X_t = \delta + \varphi_1 X_{t-1} + \varphi_2 X_{t-2} + \dots + \varphi_p X_{t-p} + A_t \quad (1)$$

where  $X_t$  is the observed value for the time series and  $A_t$  is the white noise. The term  $\delta$  is defined as:

$$\delta = \left( 1 - \sum_{i=1}^p \varphi_i \right) \mu \quad (2)$$

The term  $\mu$  is the process mean. In effect, AR model is a linear regression where the current value is regressed against the value of the prior period, i.e.  $X_t = Y$  and  $X_{t-1} = X$  in the Cartesian space. The term  $p$  in the equation stands for the order of the AR model. The AR model is the first type among the three common autoregressive models.

The second type of autoregressive model for univariate time series is called the *moving average* (MA) model which is given by:

$$X_t = \mu + A_t - \theta_1 A_{t-1} - \theta_2 A_{t-2} - \dots - \theta_q A_{t-q} \quad (3)$$

where  $X_t$  = time series;  $\mu$  = process mean;  $A_{t-1}$  = white noise;  $\theta_1, \dots, \theta_q$  = parameters; and  $q$  = order of the MA model (Shumway & Stoffer, 2011).

The AR model regresses the current time series  $X_t$  against its prior period  $X_{t-1}$ ; however, MA model regresses  $X_t$  against its own white noise in prior period. Since the error

term is not readily observable, forecasting under MA model is more complicated than in AR where the standard least square technique is used. In order to obtain the white noise term for the equation, an initial sample with adequate size must be used to generate the first MA model. Thereafter, more data points are added, and the changes in the error term is recorded for analysis of its distribution. This process requires larger sample size. In NPL case, this is not practicable since the problem requires quick intervention to prevent further losses (Masood et al., 2010).

A third approach to time series modeling is called the Box-Jenkins method which combined AR and MA; thus, it is called ARMA (autoregressive moving average) (Box & Jenkins, 1970). ARMA is given by:

$$X_t = \delta + \phi_1 X_{t-1} + \phi_2 X_{t-2} + \dots + \phi_p X_{t-p} + A_t - \theta_1 A_{t-1} - \theta_2 A_{t-2} - \dots - \theta_q A_{t-q} \quad (4)$$

ARMA assumes that the time series are stationary. Stationary means that the data series are reverting to its long-run equilibrium, i.e. mean reverting (Makridakis & Hibon, 1995). If there is an external shock, and the effect of the shock is integrated, the shock destroys the original long-run equilibrium. As the result, the time series lose the memory. The series are no longer mean reverting. If the effect of the shock establishes a new mean, it is said that the time series are integrated; thus, ARMA becomes ARIMA (autoregressive integrated moving average) which is given by:

$$\hat{Y}_t = \mu + \phi_1 Y_{t-1} + \dots + \phi_p Y_{t-p} - \theta_1 A_{t-1} - \dots - \theta_q A_{t-q} \quad (5)$$

The second category of time series forecasting model is the multivariate type. The Box-Jenkins form for multivariate time series is called *autoregressive moving average vector* (ARIMAV):

$$X_t = (x_{1t}, x_{2t}, \dots, x_{nt})^T \quad \text{where } -\infty < t < \infty \quad (6)$$

The term  $X_t$  is further defined as:

$$X_t = \phi_1 X_{t-1} + \phi_2 X_{t-2} + \dots + \phi_p X_{t-p} + A_t - \theta_1 A_{t-1} - \theta_2 A_{t-2} - \dots - \theta_q A_{t-q} \quad (7)$$

where  $X_t$  and  $A_t$  are  $n \times 1$  column vector, and  $A_t$  is the multivariate white noise. For the parameter term,  $\phi_k = \{\phi_{k,jj}\}, k = 1, 2, \dots, p$  and  $\theta_k = \{\theta_{k,jj}\}, k = 1, 2, \dots, p$  both are  $n \times n$  matrices for autoregressive and moving average parameters. Note that  $E[A_t] = 0; E[A_t A_{t-k}] = 0, k \neq 0$  and  $E[A_t A_{t-k}] = \sum A, k = 0$  where  $\sum A$  is the dispersion or covariance matrix of  $A_t$ .

The weakness of ARIMA is that the estimate of parameters and covariance matrix is not easy. This complexities may be illustrated by ARIMA(p,q) where the parameter  $p = 2$  and  $q = 0$ , the ARIMAV(2,0) model may be written as:

$$\begin{pmatrix} X_t \\ Y_t \end{pmatrix} = \begin{pmatrix} \phi_{1,11} & \phi_{1,12} \\ \phi_{1,21} & \phi_{1,22} \end{pmatrix} \begin{pmatrix} X_{t-1} \\ Y_{t-1} \end{pmatrix} + \begin{pmatrix} \phi_{2,11} & \phi_{2,12} \\ \phi_{2,21} & \phi_{2,22} \end{pmatrix} \begin{pmatrix} X_{t-2} \\ Y_{t-2} \end{pmatrix} - \begin{pmatrix} A_{1t} \\ A_{2t} \end{pmatrix} \quad (8)$$

where  $X$  = input and  $Y$  = output; both with the mean vector of (0,0). The scalar form of ARIMA(2,0) is written separately for  $X$  and  $Y$  as:

$$X_t = \phi_{1,11}X_{t-1} + \phi_{2,11}X_{t-2} + \phi_{1,12}Y_{t-1} + \phi_{2,12}Y_{t-2} + A_{1t} \quad (9)$$

$$Y_t = \phi_{1,22}Y_{t-1} + \phi_{2,22}Y_{t-2} + \phi_{1,21}X_{t-1} + \phi_{2,21}X_{t-2} + A_{2t} \quad (10)$$

These complications (5–10) are not practicable and may be inaccessible for practitioners in NPL assessment. Both univariate and multivariate time series models could not effectively be used as tools for short-term risk assessment in NPL study; in NPL study the event-to-date is provided on a quarterly basis and the needed forecast is also quarter-to-quarter. Moreover, time series modeling requires larger sample size. This requirement is not suitable for NPL problem where immediate and short-term interventions are needed. Secondly, time series modeling could not provide any information on the internal system that generates the NPL rates. The limitation of time series autoregressive models is due to the fact that the series regresses against its own past series. Neither AR, ARMA, ARIMA nor ARIMAV could tell us about “how reliable does the system behave?” The answer to this question could help us better model by assessing the current situation and forecast future event. Specifically, autoregressive in time series could not provide information on the current circumstance of the system. Autoregressive time series could not answer the question: “what is the reliability and risk of the failure of NPL as a system?”

In NPL analysis, the NPL level is considered as time-to-event data, not just a mere event occurring with corresponding time, i.e. time series data. The issue of system failure and system survival has practical importance on management decision making because time-to-event modeling allows us to capture the characteristics of failure with respect to time and assess the current condition of the system.

Time series data modeling does not differentiate between success or failure; the observed values in time series are not classified. Each value is connected to time:  $X_i : t_i$ . This generalization of data makes time series modeling a tool for crude estimate. The weakness of time series comes from the fact that all time series depend on autoregression, i.e. the  $Y$ -array is obtained through a lag of the time series or that each  $X_t$  is lagged to  $X_{t-1}$ ; thus, the modeling is a regression of the data series against itself by using the previous period as the basis for the next event (Box *et al.*, 1994, pp. 9-10). This type of autoregressive modeling could allow only simple forecasting without assessing the underlying condition of the system that produces the event. The weakness of time series modeling underscores the inadequacy of the current tools in econometrics for purposes of risk assessment or forecasting crisis. This inadequacy is best exemplified by these words of the former European Central Bank President, Jean-Claude Trichet who remarked:

“When the crisis came, the serious limitations of existing economic and financial models immediately became apparent. Arbitrage broke down in many market segments, as markets froze and market participants were gripped by panic. Macro models failed to predict

the crisis and seemed incapable of explaining what was happening to the economy in a convincing manner. As a policy-maker during the crisis, I found the available models of limited help. In fact, I would go further: in the face of the crisis, we felt abandoned by conventional tools. In the absence of clear guidance from existing analytical frameworks, policy-makers had to place particular reliance on our experience. Judgement and experience inevitably played a key role.” (Trichet, 2010).

Times series modeling is a common method in econometrics (Lin et al., 2003). Time series modeling uses the prior period’s sequential values as the basis for predicting the subsequent period (Green, 2011). This approach tends to require large sample size (Brockwell & Davis, 2002). In NPL studies, managers and policy makers do not have the luxury of lengthy period for data collection prior to making the forecast. NPL is a practical problem requiring an immediate intervention. Therefore, time series may not be an appropriate tool. This paper proposes the use of non-parametric method in system analysis as a tool for short-term risk assessment in NPL studies under Extreme Value Theory (EVT). This research employs data distribution verification through tail index calculation as the means for model selection and testing.

### 3. METHODOLOGY

The methodology section consists of three parts. The first part explores time series as a possible tool for NPL modeling. The second part explores the feasibility of extreme value analysis under Generalized Extreme Value (GEV) theory as a potential modeling tool for NPL studies. The third part explains series of statistical tests used for data analysis.

As a preliminary step to system analysis, we engage extreme value analysis (EVA) to verify data distribution. It is necessary to verify data distribution because with known distribution type, appropriate statistical tests may be selected for hypothesis testing (Stuart, 1999) and model selection (Burnham & Anderson, 2002). In the present case, we have ten industries with eight operating quarters between 2013 and 2014. The mean values for eight quarters of the ten industries are used as the observed data set.

**Table 2: Verify Extreme Values via Ranked Mean Values**

Industry	Ranked Mean	Mean	SD	Z Score
Other	0.01	9.08	10.70	(0.85)
Mining	0.18	9.08	10.70	(0.83)
Finance	0.29	9.08	10.70	(0.82)
Agriculture	1.47	9.08	10.70	(0.71)
Public Utilities	3.60	9.08	10.70	(0.51)
Construction	3.77	9.08	10.70	(0.50)
Services	8.97	9.08	10.70	(0.01)
Realty	9.42	9.08	10.70	0.03
Wholesales	15.34	9.08	10.70	0.58
Per. Cons.	27.21	9.08	10.70	1.69
Manufacture	29.64	9.08	10.70	1.92

If the standard score proves that some of the values in the array are significantly large or small, the array is treated as a candidate for extreme value distribution analysis. The standard score is given by:

$$Z = \frac{X_i - \bar{X}}{S} \quad (11)$$

To discover extremely large number the subscript  $i$  is substituted with maxima in the array and *vice versa* for the extremely small value. After extreme values are discovered, the next step is to verify the type of extreme value distribution. There are three types of extreme value distribution, namely Gumbel, Fréchet and Weibull distributions. Extreme values may be analyzed under the generalized extreme value (GEV) distribution proposed by Fisher-Tippett-Gnedenko:

$$H(x; \mu, \sigma, \xi) = \exp \left\{ - \left[ 1 + \xi \left( \frac{x - \mu}{\sigma} \right) \right]^{-1/\xi} \right\} \quad (12)$$

where  $\mu$  = location;  $\sigma$  = scale; and  $\xi$  = shape. If  $\xi > 0$ ,  $H$  becomes a cumulative distribution function (CDF); if  $\xi < 0$ , it is valid for  $x < \mu + \sigma/(-\xi)$ ; and if  $\xi = 0$ ,  $H$  is undefined (Bensalah, 2000). However, if  $\xi \rightarrow 0$ , then  $H(x; \mu, \sigma, \xi)$  is reduced to:

$$H(x; \mu, \sigma, 0) = \exp \left\{ - \left( \frac{x - \mu}{\sigma} \right) \right\} \quad (13)$$

The parameter  $\xi$  is the tail index of the distribution. This index may be used to classify the type of extreme value distribution. If  $\xi = 0$ , the  $H$  distribution is Gumbel distribution, also known as Type I where  $x \in \mathfrak{R}$  and  $\xi = 0$ . The Gumbel distribution is given by:

$$H(x; \mu, \sigma, 0) = \exp \left\{ - \exp \left( \frac{x - \mu}{\sigma} \right) \right\} \quad (14)$$

If  $\xi > 0$ , the  $H$  distribution is a Fréchet distribution or Type II. The Fréchet distribution is given by:

$$H(x; \mu, \sigma, \xi) = \begin{cases} 0 & \text{for } x < \mu \\ \exp \left\{ \left( \frac{x - \mu}{\sigma} \right)^{-\alpha} \right\} & \text{for } x > \mu \end{cases} \quad (15)$$

If  $\xi < 0$ , the  $H$  distribution is Weibull distribution or Type III. The Weibull distribution is given by:

$$H(x; \mu, \sigma, \xi) = \begin{cases} \exp\left\{-\left(-\left(\frac{x-\mu}{\sigma}\right)\right)\right\}^{-\alpha} & \text{for } x < \mu \\ 1 & \text{for } x \geq \mu \end{cases} \quad (16)$$

The next step is to classify the type of extreme value distribution of the series through the use of the tail index. The tail index may be estimated. There are two methods for the tail index estimation: the Pickand method (Pickand, 1975), and the Hill method (Wagner and Marsh, 2000). Firstly, the Pickand method is given by:

$$\hat{\xi}_{k,m} = \frac{1}{m} \sum_{i=1}^k (\ln X_{n-i+1} - \ln X_{n-m}) \quad (17)$$

where  $m$  = number of observations whose tail is to be observed and  $k$  = sample size. Secondly, the Hill method is given by:

$$\hat{\xi}_{k,T} = \frac{1}{k} \sum_{i=1}^k (\ln R_{i,T} - \ln R_{k,T}) \quad (18)$$

where  $R = \sigma Z$ ; recall that  $\sigma$  is the estimated population standard deviation and  $Z$  is the standard score of the series. Both methods follows the same conditions in providing the decision rule for classifying the type of extreme value distribution: *Frechet* =  $\xi > 0$ , *Weibull* =  $\xi < 0$  and *Gumbel* =  $\xi = 0$ . The Hill method of estimating the tail index was used.

### 3.2 Statistical Testing According to Data Distribution

The NPL data set is classified as event-to-date data. Testing for the individual industries data distribution shows that there are distributed Fréchet and Weibull. Thus, Fréchet and Weibull distribution modeling are used for individual industry analysis.

*Weibull Distribution.* The Weibull Distribution is used to obtain the system hazard function. The hazard function is an appropriate tool because NPL represents system failure and hazard function deals with system failure. In order to evaluate and forecast the system, it is necessary to verify its failure and survival rate. The following steps are used to obtain Weibull predictive function.

Firstly, the time-to-failure is obtained by:

$$F(t) = \frac{(i+0.30)}{(n+0.40)} \quad (19)$$

Secondly, from equation (19), the X-array for the QQ-plot is generated by:

$$X_i = \ln\left(\ln\left(\frac{1}{1-F(t)}\right)\right) \quad (20)$$

This X-array is generated via time counts of events in the data set. In the present case, there are eight quarters of NPL rates reported by the Bank of Thailand.

Thirdly, generate the Y-array for the QQ-plot by using the observed NPL values for the eight quarters in each industry as the basis; thus:

$$Y_i = \ln(NPL_i) \quad (21)$$

With known XY-arrays, we could not generate a Weibull linear regression equation for each industry in a form of  $Y_W = a + bX + c$  from which the Weibull statistics are calculated. These Weibull statistics include:  $\beta$ ,  $\eta$ ,  $R$ ,  $h(t)$ , and  $s(t)$ .

From the Weibull linear equation, the Weibull statistics are obtained. These statistics provides information about the underlying condition of the process. Firstly, the *beta* value is calculated by:

$$\beta = \frac{1}{b} \quad (22)$$

If  $\beta > 1$ , it means that the system failure is increasing with respect to time. If  $\beta < 1$ , it means that the system failure is decreasing with respect to time. If  $\beta = 1$ , it means that the system failure is stable.

The second Weibull statistic is *eta*:  $\eta$  which is obtained by:

$$\eta = e^a \quad (23)$$

*Eta* informs us about the scale of the failure distribution. In the present case, the reading of the NPL data commences quarter 1 of 2013 and ends on quarter 4 of 2014.

The third Weibull statistic that provides failure information is the Cumulative Distribution Function (CDF). The CDF value provides the total failure reading in percentage distribution form from the beginning to end of the time interval. This value was obtained by:

$$CDF = 1 - \exp\left(-\frac{X}{\eta}\right)^{1/\beta} \quad (24)$$

The fourth Weibull reading is the system reliability. If the system has a total failure of 0.48 in the entire period, how reliable is the system in producing such a failure? The answer to this question is given by the system reliability:  $R$  whose value is determined by:  $R = 1 - CDF$ .

The last set of Weibull statistics are the instantaneous failure rate:  $h(t)$  and the system survival rate:  $s(t)$  which are given by:

$$h(t) = \left( \frac{\beta}{\eta^\beta} \right) \left( X^{\beta-1} \right) \exp \left( -\frac{X}{\eta} \right)^\beta \quad (25)$$

$$s(t) = \exp(-h(t)) \quad (26)$$

The value of  $h(t)$  indicates the rate of instantaneous failure of the system. In the present case,  $h(t)$  indicates the probability that the NPL would fail at any given time. Conversely,  $s(t)$  provides us with the information about the survival rate of the NPL.

*Fréchet Distribution.* Under EVT, Type II distribution or fat-tailed distribution is called Fréchet distribution. The Cdf of the Fréchet distribution is given by:

$$\Phi_F(X) = \exp \left[ \left( \frac{x - \mu}{\sigma} \right) \right]^{-\alpha}$$

The distribution typed was verified by the tail index. The industries that manifested Fréchet distribution are then further selected by the following condition:  $x_i > \mu$  where  $x_i$  are the individual quarter's NPL rates and  $\mu$  is their estimated mean.

*Generalized Extreme Value.* The third analysis involves the use of the entire ten industries as a single data set and tested it under GEV using the tail index as the lead indicator to calculate the risk threshold against which the ten industries' NPL are used for purposes of risk ranking.

### 3.3 Statistical Tests Used

The following tests have been used for preliminary data analysis: sample size determination, data distribution test, randomness test, and trend test.

*Minimum sample size* is determined by using the confidence interval estimation method suggested by Gou et al. (2013). According to Gou, the minimum sample size for Weibull's distribution function may be obtained by:

$$1 - CI = R^n \quad (27)$$

where  $CI$  = confidence interval;  $R$  = Weibull reliability; and  $n$  = sample size. The confidence used for sample size determination is 99%. Since  $1 - CI = \alpha$ , equation (27) may be written as:

$$\alpha = R^n \quad (28)$$

The mean of the Weibull reliability for the study period is  $R + SD = 0.51$ . Using 0.99 as the confidence interval, the value for alpha is  $\alpha = 0.01$ . The sample size is  $n = 7$ . The sample size used in this research is comprised of 8 operating quarters for 10 industries. The rationale for using Gou's method for calculating sample size is supported by the fact that



weight out of ten industries manifested Weibull distribution in their NPL rates. After the minimum sample size was determined, the data was tested for distribution type.

The sample size of  $n = 7$  was confirmed by the testing of the Central Limit Theorem. The confirmation of the sample size by CLT is calculated by modifying the Lyapunov CLT. The Lyapunov equation is given by:

$$\lim_{n \rightarrow \infty} \frac{1}{S_n^{2+\delta}} E|X_i - \mu|^{2+\sigma} = 0 \quad (29)$$

Since we are dealing with small sample size, the above condition is modified to:

$$\lim_{n \rightarrow \infty} \frac{1}{S_n^{2+\sigma}} E|X_i - \mu|^{2+\sigma} \leq 0 \quad (30)$$

The limit is set to near to or less than zero. The original term  $\delta$  in the Lyapunov equation stands for *moment*, in this modified form the estimated standard deviation  $\sigma$  is used. The modification is affected to accommodate small sample size studies.

**Table 3: Sample Size Calculation under Central Limit Theorem**

Item	TYPE OF INDUSTRIES								
	1	2	3	4	5	6	7	8	9
1	1.50	0.20	34.25	3.97	14.25	0.34	9.75	2.15	23.52
2	1.46	0.18	32.32	3.83	14.48	0.42	9.12	3.92	23.93
3	1.59	0.21	30.70	3.87	14.69	0.30	9.34	3.83	25.68
4	1.52	0.17	29.42	3.84	15.34	0.26	9.15	4.21	26.89
5	1.52	0.16	29.02	3.93	14.70	0.25	9.09	4.30	28.18
6	1.45	0.18	27.46	3.79	15.37	0.24	10.17	4.22	28.81
7	1.35	0.17	26.69	3.51	16.34	0.25	9.69	3.55	30.66
8	1.33	0.17	27.26	3.42	17.58	0.27	9.06	2.62	30.03
9	1.50	0.20	34.25	3.97	14.25	0.34	9.75	2.15	23.52
10	1.46	0.18	32.32	3.83	14.48	0.42	9.12	3.92	23.93
<i>n</i>	8	8	8	8	8	8	8	8	8
<i>Mean</i>	1.47	0.18	29.64	3.77	15.34	0.29	9.42	3.60	27.21
<i>S</i>	0.09	0.02	2.65	0.20	1.12	0.06	0.41	0.80	2.68
$\mu$	1.41	0.17	27.90	3.64	14.61	0.25	9.15	3.07	25.45
$\sigma$	0.10	0.02	2.99	0.22	1.26	0.07	0.46	0.90	3.02
<i>Limit</i>	0.00	0.00	15.91	0.01	0.37	0.00	0.04	0.15	17.09
<i>CLT</i>	Yes	Yes	No	Yes	No	Yes	Yes	No	No

The determination whether the data distribution falls within the confine of normal distribution curve under the CLT assumption is accomplished by binomial frequency counts and tested by the DeMoivre-Laplace Central Limit Theorem for binomial distribution. The DeMoivre-Laplace equation is given by:

$$\lim_{n \rightarrow \infty} \Pr \left( \frac{X - np}{\sqrt{npq}} \right) \leq Z \quad (31)$$

Using 0.95 confidence interval, the critical value for Z is 1.65. The calculation for Z produced an observed value of 1.30. This value was verified by a second Z binary equation:

$$Z = \frac{\frac{X}{n} - p}{\sqrt{\frac{pq}{n}}} \quad (32)$$

The result of this calculation shows that the Z(obs) is 1.32. In both cases, the null hypothesis could not be rejected. The decision rule was:  $H_0: Z(\text{obs}) < 1.65$  means that the data distribution falls within the normal curve;  $H_A: Z(\text{obs}) > 1.65$  means that the data distribution falls outside of the confidence interval. In the present case,  $1.32 < 1.65$  and  $1.30 < 1.65$ ; both binary methods confirm that the data set satisfied the requirement of CLT. The sample size used for this research is  $n = 8$ . According to the CLT test, it is considered adequate.

*Data distribution test* is accomplished by Anderson-Darling (AD) (Anderson & Darling, 1952). The rationale is to verify whether the data is normally distributed because most statistical tests require that the data be normally distributed. With known distribution type, appropriate statistical tests could be used. The AD test consists of two steps: first, determine the observed value for AD and second, compare the observed AD value to that of the theoretical value:  $AD^*$ . The observed value for AD is obtained through:

$$AD = -n - S \quad (33)$$

where  $S$  is defined as:

$$S = \sum_{i=1}^n \left( \frac{2i-1}{n} \right) [\ln(F(Z)) + \ln(1-F(Z))] \quad (34)$$

The theoretical value for  $AD^*$  is given by:

$$AD^* = AD \left( 1 + \frac{0.752}{n} + \frac{2.25}{n^2} \right) \quad (35)$$

The decision rule is:  $H_0: AD < AD^*$  assumed to be normally distributed and  $H_A: AD > AD^*$  assumed to be non-normally distributed. The data from the 10 industries are normally distributed because  $AD < AD^*$ . After the data distribution was verified, the data was tested for randomness.

*Data randomness* is verified by the adjacent test. The rationale for randomness test comes from the fact that most statistical tests require randomness in the data set. The adjacent test is given by:

For  $n < 25$ , the test statistic is given by:

$$L_{n < 25} = \frac{\sum_{i=1}^{n-1} (x_{i+1} - x_i)^2}{\sum_{i=1}^n (x_i - \bar{x})^2} \quad (36)$$

The null hypothesis assumes normal distribution and this assumption may be rejected if the test statistic lies outside the lower and upper bounds of the critical value. The hypothesis statement is:  $H_0 : L_{lower} < L_{obs} < L_{upper}$  and the data is non-random if  $L_{obs}$  lies outside of the lower and upper boundaries. In case where the data set may fall out of the L-bounds, it is necessary to test whether the data manifest significant trend.

*Trend test* was used to confirm whether the NPL rates manifest any trends: recognizable patterns with magnitude and direction. Trend may be classified as improving or deteriorating trend. There are three types of trend tests commonly in use: (i) Military Handbook Trend Test (MHB); (ii) Laplace Trend Test; and (iii) Reverse Arrangement Test (NIST, Engineering Handbook, 2013). The Military Hand Book's approach is given by:

$$\chi_{2r}^2 = 2 \sum_{i=1}^r \ln \left( \frac{T_{end}}{T_i} \right) \quad (37)$$

The MHB approach requires that the data comes from a system that follows Power Law, i.e. one quantity varies as a power of another quantity. In the present case, the NPL data set does not qualify because in the eight quarters for the ten industries, the change from quarter-to-quarter does not follow the Power Law.

The second approach to trend test is given by the Laplace Trend Test which is based on the assumed normal distribution of the data set and uses the Z-test:

$$Z_{LP} = \frac{\sqrt{12r} \sum_{i=1}^r \left( T_i - \frac{T_{end}}{2} \right)}{rT_{end}} \quad (38)$$

Under the Laplace approach, the data must follow exponential model. In the present case, the NPL rates for the studied period manifest normal distribution, but did not change exponentially. The third trend test is called the Reverse Arrangement (RA) Test. This is the trend test applicable to NPL data in the present case. The RA test is given by:

$$Z_{RA} = \frac{R - \left( \frac{r(r-1)}{4} \right) + 0.50}{\sqrt{\frac{(2r-5)(r-1)r}{72}}} \quad (39)$$

The NPL data is tested under the RA test to verify whether there significant trend exists in the loan failure among the 10 industries.

#### 4. RESEARCH RESULTS

The findings are presented in four parts. The first part presents the preliminary data testing for distribution, randomness and trends. The second part presents the risk analysis of individual industries under Weibull distribution as suggested by the tail index. The second part analyzes two industries whose tail index suggests a Fréchet distribution. Lastly, the third part presents the ten industries under Fisher-Tipett-Gnedenko's generalized extreme value model.

##### 4.1 Preliminary Statistical Tests for Data Verification

The distribution test verified that the data sets from 10 industries over a period of 8 operating quarters are normally distributed. This result was obtained through the Anderson-Darling test.

**Table 4: Distribution Type under Anderson-Darling Test**

Industry	AD(obs)	AD*	Distribution
Agriculture	150.49	165.16	Normal
Mining	165.16	181.26	Normal
Manufacturing	162.37	178.20	Normal
Construction	143.38	157.36	Normal
Wholesales	167.97	184.34	Normal
Finance	170.76	187.41	Normal
Realty	166.27	182.49	Normal
Public utilities	142.49	156.39	Normal
Services	156.62	171.89	Normal
Personal consumption	153.45	168.41	Normal

To verify whether the NPL rates for the 8 operating quarters show any significant trend,  $Z_{RA}$  test was used. The results of  $Z_{RA}$  for the ten industries are presented in Table 3. There are two types of trend, namely degrading trend if  $Z_{RA} < 0$  and improving trend if  $Z_{RA} > 0$ . If  $Z_{RA} = 0$ , there is no trend. For degrading trend, with 8 operating quarters, the threshold value for  $Z_{RA}(8,0.95)$  is 6. For the improving trend in this study,  $Z_{RA}(8,0.95)$  is 22. The result of the trend test is presented in Table 4.

**Table 5: Data Trend Test of NPL Rates for Ten Industries**

Industry	R	Trend(obs)	Trend(0.95)	Conclusion
Agriculture	8	-2.05	6.00	No significance
Mining	11	-1.03	6.00	No significance
Manufacturing	4	-3.42	6.00	No significance
Construction	7	-2.39	6.00	No significance
Wholesales	9	-1.71	6.00	No significance
Finance	12	-0.68	6.00	No significance
Realty	4	-3.42	6.00	No significance
Public utilities	13	-0.34	6.00	No significance
Services	12	-0.68	6.00	No significance
Per. Cons.	9	-1.71	6.00	No significance

All industries show negative observed trend under  $Z_{RA}$  test. The negative value indicates that there is a decreasing trend. Decreasing trend in NPL means a reduction in NPL incidences. However, the threshold for the significance test under 95% confidence interval is 22; all observed trends are less than 22. Thus, the observed reduction in NPL incidence is not statistically significant.

To verify whether the data was random, the adjacent test was used. Table 4 shows that the data sets from 4 industries are found to be randomly distributed; the remaining 6 sets are non-random. Random is defined as the lack of recognizable pattern. Thus, when there is non-random finding, it is suspected that the data may show recognizable pattern. A recognizable pattern in NPL would mean that the failure of the loans may come from structural problem which policy makers could target with corrective measures. This pattern could not be confirmed by the reverse arrangement trend test. The result of the trend test proved that for all 10 industries, no sector shows significant trend.

**Table 6: Randomness Test of the NPL Rate for the 10 Industries**

Industry	L(obs)	L(lower)	L(upper)	Result
Agriculture	0.74	0.98	3.22	Non-random
Mining	1.95	0.98	3.22	Random
Manufacturing	0.31	0.98	3.22	Non-random
Construction	0.57	0.98	3.22	Non-random
Wholesales	0.45	0.98	3.22	Non-random
Finance	1.11	0.98	3.22	Random
Realty	2.32	0.98	3.22	Random
Public utilities	1.73	0.98	3.22	Random
Services	0.25	0.98	3.22	Non-random
Personal consumption	0.21	0.98	3.22	Non-random

As part of the preliminary test, the data was also modeled under times series *autoregressive* modeling in order to assess the efficacy of time series modeling. The AR models for the 10 industries from eight operating quarters are summarized in Table 7.

**Table 7: AR Models with Corresponding T-Value and R-Square**

Industry	AR Model	T-Value	R <sup>2</sup>
Agriculture	$Y_1 = 0.31 + 0.78X$	1.76	0.38
Mining	$Y_2 = 0.17 + 0.02X$	0.04	0.00
Manufacturing	$Y_3 = 7.31 + 0.74X$	8.46	0.93
Construction	$Y_4 = 0.00 + 1.00X$	2.70	0.59
Wholesales	$Y_5 = -4.99 + 0.53X$	3.78	0.74
Finance	$Y_6 = 0.12 + 0.53X$	1.47	0.30
Realty	$Y_7 = 10.22 - 0.09X$	0.20	0.01
Public utilities	$Y_8 = 2.32 + 0.89X$	0.37	0.03
Services	$Y_9 = 0.93 + 0.89X$	4.85	0.83
Personal consumption	$Y_{10} = 4.53 + 0.87X$	6.38	0.89
All Industries	$Y_{group} = 9.69 + 0.03X$	0.06	0.0007

The purpose of reporting AR Models for the ten industries' NPL is to contrast the different modeling efficacy in time series approach and that of system analysis employed by this paper. The time series modeling is brutally efficient. It regresses the current item against its own past. Although this approach tends to produce higher level of correlations and thus higher coefficient of determination, the R-square score in this case is quite low. This may be due to the fact that the ten industries do not have uniform distribution. This distribution diversity is shown in Table 7.

#### 4.2 Individual Industry Analysis by Distribution Type

Each industry was tested for outlier values by using the standard score method. Once the outliers are found, the tail index was calculated to verify the type of distribution for each industry's NPL data set. The Hill method was used in calculating the tail index.

The calculation in the paper breaks tradition with conventional EVT in that this paper does not separate extreme sets  $G(x)$  from the original observations  $F(x)$  due to limited sample size. Once the existence of extreme value is verified by the standard score equation:  $Z = (x_i - \bar{x})/S$ , the entire eight quarters are treated as an extreme set, thus making  $G(x) \cong F(x)$ .

**Table 8: Tail Index for NPL of Each Industry**

Industry	$Z \geq 1.65$	Tail Index ( $\xi_i$ )	Distribution	Index Method
Agriculture	No	(10.86)	Weibull	Hill's Method
Mining	Yes	(14.05)	Weibull	Hill's Method
Manufacturing	Yes	(2.01)	Weibull	Hill's Method
Construction	Yes	(35.03)	Weibull	Hill's Method
Wholesales	Yes	(13.01)	Weibull	Hill's Method
Finances	Yes	(9.53)	Weibull	Hill's Method
Realty	Yes	(1.85)	Weibull	Hill's Method
Public Utilities	Yes	(3.48)	Weibull	Hill's Method
Services	No	0.43	Fréchet	Hill's Method
Per. Consumption	No	3.08	Fréchet	Hill's Method

The findings in Table 3 suggest that among the ten industries, there are two types of data distribution. Eight industries are distributed Weibull and two industries are distributed as Fréchet. This finding has a practical implication for policy makers and risk manager. Prior to distribution type analysis, NPL rates are presented as figures for the ten industries. Forecasting future events for NPL or determining the direction of improving of deteriorating trend of NPL would have been haphazard since policy makers would treat all ten industries as a single group. However, the tail index calculation differentiates the ten industries into two groups. Industries whose NPL data is distributed as Weibull would be analyzed under Weibull distribution; those that are distributed as Fréchet distribution would also be analyzed under that distribution. The tail index helps the researcher in NPL studies to be more accurate by employing correct analytical tools.

### 4.3 Weibull Distribution Analysis and the Implication for NPL Risk

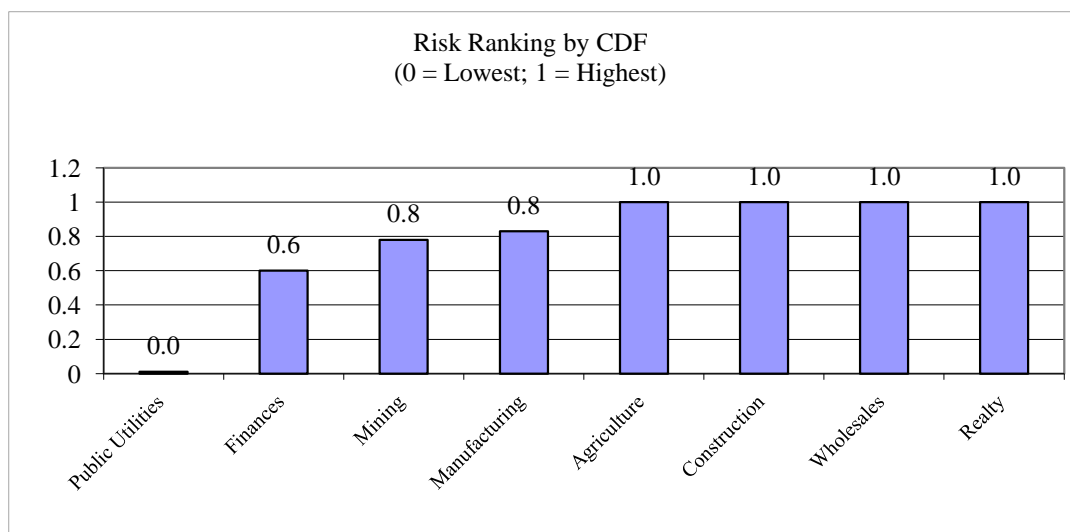
The NPL rates of eight industries manifest Weibull distribution. The risk level under Weibull analysis is determined by the Weibull CDF. The system reliability un Weibull analysis indicates the percentage reliability of the system to produce NPL. The direction of the NPL trend is given by  $\beta$ . If  $\beta < 1$ , it means that NPL will decrease with respect to time. If  $\beta > 1$ , it means that NPL will increase with respect to time and if  $\beta = 1$ , there is no change in trend direction. The Weibull statistics are summarized in the table below. The predictive value is the last period's NPL rate.

**Table 10: Weibull Statistics for Eight Industries**

Industry	$a$	$b$	$\beta = 1/b$	$\eta = \exp(a)$	$CDF$	$R = 1 - CDF$
Agriculture	0.36	(0.03)	(33.33)	1.43	1.00	-
Mining	(1.75)	(0.05)	(18.86)	0.17	0.78	0.22
Manufacturing	3.35	(0.08)	(12.74)	28.50	0.83	0.17
Construction	1.31	(0.04)	(26.16)	3.71	1.00	-
Wholesales	2.76	0.06	18.09	15.80	1.00	-
Finances	(1.32)	(0.13)	(7.64)	0.27	0.60	0.40
Realty	2.24	(0.002)	(412.70)	9.39	1.00	-
Public Utilities	1.29	0.07	14.63	3.63	0.01	0.99

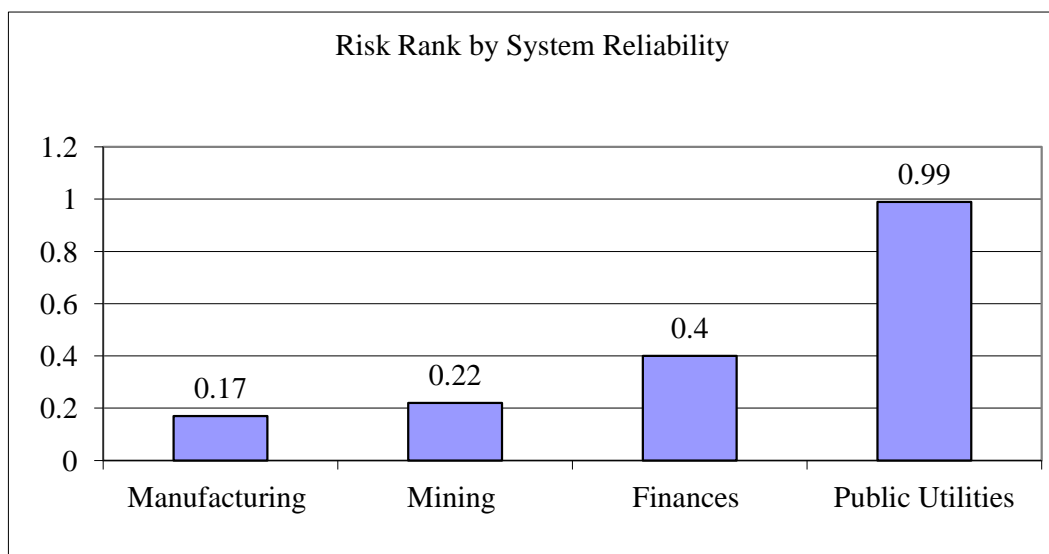
There are eight industries which manifest Weibull distribution. A picture of time-trend emerges from the Weibull statistics:  $\beta$ . There are two industries showing increasing NPL trend with respect to time. These industries include wholesales and public utilities. Therefore, they should be considered high risk sectors. The remaining six industries have  $\beta < 1$  which means that their NPL trend is decreasing with respect to time. For risk management purpose, the two industries with  $\beta > 1$  should be targeted for intervention measures.

**Figure 1: Risk Ranking by Weibull's CDF**



The value of eta ( $\eta$ ) indicates the scale of the NPL failure rate. The value of  $\eta$  is approximately equal to the mean of the NPL rate for the eight operating quarters for each industry. The  $\eta$  value is generally read with the CDF value. At the value of  $\eta$ , the corresponding failure rate is given by the CDF. There are four industries showing  $CDF = 1$  or at the value of  $\eta$ , there is a complete failure in the NPL system or that the reliability of the system to produce NPL is zero. Recall that we found above that the direction of the trend for these industries is decreasing with time (except wholesales), a condition  $CDF = 1$  means that the NPL risk level is improving or reducing. The positive beta of the wholesales industry indicates that its NPL risk is real and will probably continue to increase. These conclusions must be read with the system reliability. The higher the  $R$  value, the more reliable the system will produce NPL. In this case, public utilities industry has a system reliability of 0.99 or the highest among the eight industries.

**Figure 2: Risk Ranking by Weibull’s System Reliability  $R$**



There are four industries with a score of zero; they have been dropped from the risk ranking according to system reliability indicator. These industries include: agriculture, construction, wholesales and realty. The finding of  $R = 0$  implies that the NPL rates in these industries are not due to structural defect, but due to random chance. For  $R > 0$ , it means that NPL operates as a system and that system is adequately reliable to the extend indicated by the value of  $R$  to produce NPL. Another way of looking at the  $R$ -value is that for  $R > 0$ , the failure comes from the system or process. The highest risk in the Weibull group is public utilities. For policy and decision making purposes, this industry requires corrective measures.

#### 4.4 Fréchet Distribution Analysis and the Implication for NPL Risk

The result in Table 3 shows that there are two industries whose NPL rates are distributed Fréchet: services and personal consumption. Using the Fisher-Tippett-Gnedenko equation to solve for the Generalized Extreme value (GEV)’s cumulative distribution function (CDF) value, it was determined that both industries had  $H(x; \mu, \sigma, \xi) = 0.19$ . The CDF is defined as the percentage probability of failure or NPL rates that falls under the



Fréchet distribution curve. This is the amount of failure expressed in terms of percentage probability. The system survival rate or percentage probability for NPL in the two industries to continue manifesting themselves in the system is  $R = 1 - CDF$  or 0.81. The probability that these two industries (services and personal consumption) to continue to have extreme risk is 81%. The level of that risk is 19%.

This result came from two items. Due to unusually small sample size, the findings under Fréchet distribution for individual industries may not be reliable. It is more advisable to use GEV for the entire group of ten industries since in GEV, data sets that are distributed Weibull and Fréchet may be generalized under  $H(x; \mu, \sigma, \xi)$ .

#### 4.5 Combined Industry Group Analysis under Fisher-Tippett-Gnedenko Method

The same procedure was repeated for the ten industries as a group. This second stage of the calculation was accomplished by using the mean of each industry's eight operating quarters as an individual observation; thus, there are ten individual observed values for the group.

According to the literature, Weibull and Fréchet distributed data sets may be analyzed under the Generalized Extreme Value equation known as the Fisher-Tippett-Gnedenko GEV equation (Embrechts et al., 1999). The result of the tail index calculation is reported in Table 4 in a ranked format according to NPL rates in ascending order.

**Table 11: Group Tail Index for Ten Industries**

Industry	Mean NPL	$R_j = \sigma Z$	$R_k$	Tail Index ( $\xi_j$ )
Mining	0.18	(10.88)	-	-
Finance	0.29	(10.76)	-	-
Agriculture	1.47	(9.45)	-	-
Pub. Util.	3.60	(7.09)	-	-
Construction	3.77	(6.90)	-	-
Services	8.97	(1.13)	-	-
Realty	9.42	(0.63)	-	-
Wholesales	15.34	5.93	0.60	$\xi_j = 6.02$ Fréchet Distribution
Pers. Cons,	27.21	19.10	0.60	
Manufacture	29.64	21.79	0.60	

As a group, the NPL rates for the ten industries manifest Fréchet distribution. The differences in distribution findings in tables 3 and 4 is consistent with the literature which suggests that Weibull and Fréchet distribution are common and could be generalized by the Fisher-Tippett-Gnedenko equation.

Using the Hill method to verify the type of extreme data distribution, it was confirmed that  $\hat{\xi}_{k,T} = 6.02$ . As a group, the result shows that the group's NPL is Fréchet distribution. This Fréchet distribution is also known as fat-tailed or Type II extreme value distribution. In order to determine the shape of the Fréchet distribution, the QQ-plot method was used where  $X_i$  and  $Y_i$  were calculated by equations (19), (20) and (21).

According to the Fréchet distribution equation, only items:  $x > \mu$  are isolated for the QQ-plot determination. There are five items that meets this condition.

**Table 12: enerating QQ-Plot for Linear Regression to Obtain Shape Parameter**

Item	$X_{obs}$	$F(t)$	$1/(1-F(t)) = A$	$\ln(A)$	$X = \ln(\ln(A))$	$Y = \ln(X_{obs})$
1	8.97	0.13	1.15	0.14	(1.97)	2.19
2	9.42	0.31	1.46	0.38	(0.97)	2.24
3	5.34	0.50	2.00	0.69	(0.37)	2.73
4	7.21	0.69	3.18	1.16	0.14	3.30
5	9.64	0.87	7.71	2.04	0.71	3.39

With known  $X_i$  and  $Y_i$ , it is possible to determine the linear regression equation in the form of  $Y = a + bX$ . In this case, the linear regression equation is  $Y = 3.02 + 0.51X$ . Thus, the shape of the Fréchet is  $\alpha = 1/b = 1/0.51 = 1.97$ . The positive shape tells us that there is an increasing trend with respect to time (Weibull, 1951). According to this decision rule, it means that the NPL trend in Thailand is increasing with time.

The industries may be ranked according to the magnitude of risk derived from their respective NPL rate. This ranking is summarized in Figure 1 reading from left to right: lowest-to-highest risk level. Two industries: personal consumption and manufacturing are considered extreme cases. These two industries are the most risky. The remaining five industries: public utilities, construction, services, realty, and wholesales, are considered within 0.95 confidence interval or tolerance level. There are three industries: agriculture, finance, mining, and other, are considered non-risky sectors.

The risk assessment of the industries must be read with the scale of the failure. The scale for the Fréchet distribution may be obtained through the maximum likelihood method (Abbas & Yincai, 2012). The likelihood function is given by:

$$L_n(\alpha, \beta) = \alpha^n \beta^{na} \prod_{i=1}^n x_i^{-(\alpha+1)} \exp \left[ -\sum_{i=1}^n \left( \frac{\beta}{x_i} \right)^\alpha \right] \quad (40)$$

Abbas and Yincai further suggest that by solving for:  $(\partial \log L_n(\alpha, \beta)) / \partial \beta = 0$ , the maximum likelihood of the failure level may be obtained, thus:

$$\hat{\beta}_{ML} = \left( \frac{n}{t} \right)^{1/\alpha} \quad (41)$$

where  $\alpha$  = shape of the curve determined by 1/slope;  $n$  = sample size which accounts for 7 industries meeting the condition  $x > \mu$ , and  $t = \sum (1/X_i)^\alpha$ . In this case, the calculation shows that  $\hat{\beta}_{ML} = 10.91$ . This value is the threshold of NPL level beyond which is considered high risk. According to the likelihood method, three industries are qualified as high risk or risky: wholesales (15.34), personal consumption (27.21) and manufacturing

(29.64). Under the standard score method, only two industries (personal consumption and manufacturing), were identified as risky because 0.95 CI was used. Under the maximum likelihood method, the threshold point seems to have been reduced to 80%. While the standard score method relies on pre-defined confidence interval as the threshold point, the maximum likelihood method relies on the parameters of the Fréchet distribution. This different approach under the two methods explains the different findings in identifying the risky industry. This final risk identification is summarized in Table 11.

**Table 13: Identify Risky Industry under Generalized Extreme Value Method**

Industry	X(obs)	a	b	$Y = 3.02 + 0.51X$	Threshold	Risky
Mining	0.18	3.02	0.51	3.11	10.91	No
Finance	0.29	3.02	0.51	3.17	10.91	No
Agriculture	1.47	3.02	0.51	3.77	10.91	No
Pub. Util.	3.60	3.02	0.51	4.86	10.91	No
Construction	3.77	3.02	0.51	4.94	10.91	No
Services	8.97	3.02	0.51	7.59	10.91	No
Realty	9.42	3.02	0.51	7.82	10.91	No
Wholesales	15.34	3.02	0.51	10.84	10.91	No
Pers. Cons.	27.21	3.02	0.51	16.90	10.91	Yes
Manufacture	29.64	3.02	0.51	18.14	10.91	Yes

In the final analysis, there are two industries which are most risky. These industries are personal consumption (16.90) and manufacture (18.14). The threshold risk level used is 10.91 obtained by  $\hat{\beta}_{ML}$ . This conclusion may be confirmed by Cohen's  $d$  effect size determination. Effect size is the measure of the strength of the phenomenon (Ken and Preacher, 2012). The Cohen's  $d$  is given by:

$$d = \frac{\bar{X}_1 - \bar{X}_2}{S_n} \quad (42)$$

The mean for the first group is  $\bar{X}_1 = (27.21 + 29.64) / 2 = 17.53$ . The mean for the second group is just the value of the threshold or  $\bar{X}_2 = 10.91$ . The standard deviation comes from the combined sets; thus:  $S_n = 3.87$ . The resulting effect size is 1.71. This value must be read for its probability value in the probability distribution table where  $Z_{1-\alpha}(1.71) = 0.956$  or 95.6%. Under the 0.95 confidence interval, this effect size is statistically significant. Thus, personal consumption and manufacture industries present real risk in NPL. Lending in these two industries are considered significantly risky endeavor.

## 5. CONCLUSION

The significance of this research lies in the practical application of the tools proposed: system failure analysis. This research studies NPL under system failure analysis. Thailand is used as a case study. It was found that Thailand's NPL *betas* differ across industries. Some manifest increasing trends while decreasing trends. Time series modeling was reviewed and

rejected as not feasible for short-term risk management tool. Time series requires larger sample size. Large sample means longer time for data collection. In NPL where intervention is time sensitive, shorter time and smaller sample size requires a new tool. Extreme Value Theory (EVT) was used as an alternative tool for NPL studies. EVT is more appropriate because it provides the means to identify and rank risk among industries. It was found that out of ten industries, two industry's NPL exceeded the threshold level determined under EVT. This finding has practical implication for policy and decision makers in NPL risk management. Prior to this research, publications in the field focus on the cause and effect of NPL, but never studied NPL as a close system. This research fills that gap. To that end, this research is a contribution to the field.

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**AN EXAMINATION OF THE RELATIONSHIPS BETWEEN SELF-PERCEPTIONS,  
CONSPICUOUS CONSUMPTION, AND SAVING BEHAVIOR**

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**ABSTRACT**

This paper seeks to examine (1) the effects of social status and the three major components of self-esteem, performance, appearance, and social self-esteem, on conspicuous consumption and (2) the impact of conspicuous consumption on saving behavior. The relationships substantiated in this study are based mainly on the perception-behavior linkage within social psychology (Chartrand & Bargh, 1999; Dijksterhuis & van Knippenberg, 1998). The data used to analyze the proposed relationships in this study were collected through an on-line survey, with a final sample size of 300 consumers. The findings show that only social status and the social dimension of self-esteem significantly affect conspicuous consumption. Surprisingly, we found no relationship between conspicuous consumption and savings. The results are discussed, along with suggestions for future research.

Keywords: Social Status, Self-Esteem, Conspicuous, Consumption, Saving



# **AN EXAMINATION OF THE RELATIONSHIPS BETWEEN SELF-PERCEPTIONS, CONSPICUOUS CONSUMPTION, AND SAVING BEHAVIOR**

## **1. INTRODUCTION**

People consume products and services to fulfill the needs in their everyday lives. Consumers purchase products or services not only because of their functional benefits but also to gain emotional benefits. One consumption phenomenon that can benefit consumers emotionally is consuming luxury products, which allows them to display their wealth and social status to boost their self-concept (Souiden, M'Saad, & Pons, 2011).

Conspicuous consumption is among the many forms of consumption people use to show off their consumption of luxury products. Now, this kind of consumption can be found in consumers within all social classes because consumers seek social approval and to boost their self-esteem (Johansson-Stenman & Martinsson, 2006). People of various social statuses can use conspicuous consumption to show the social class to which they belong. Perceived social status, together with one's self-esteem, are important factors in determining one's level of conspicuous consumption. Consumers with low self-esteem are more likely to use conspicuous consumption to maintain their self-esteem and gain social approval (Johansson-Stenman & Martinsson, 2006; Mason, 1999). While this kind of consumption may benefit luxury brand producers, it may have negative consequences in terms of some consumers' wellbeing because it can lead consumers into deep financial liabilities.

Based on the above-mentioned phenomenon, it is the aim of this study to examine the inter-relationships among some of the key variables that appear to have some strong linkages with conspicuous consumption: social status, self-esteem, and saving behaviors. All of these constructs are linked together based on the general perception-behavior connection within social psychology (Chartrand & Bargh, 1999; Dijksterhuis & Van Knippenberg, 1998).

By substantiating the inter-relationships among these constructs, we hope to gain insights regarding the specific types of self-perceptions that lead to conspicuous consumption. Managerially speaking, this study will benefit brand managers who seek to influence conspicuous consumption among shoppers and buyers in the market by understanding how consumers' self-perceptions may lead to this particular kind of consumption.

The remainder of this paper is organized as follows. In the next section (Section 2), we provide a review of the literature related to the four key constructs used in this study. The rationale behind our hypothesized relationships is then provided. Section 3 describes the basic characteristics of our data and research methodology. Section 4 presents the findings and discussions. The paper concludes with the implications of this study, along with some suggestions for future research in Section 5.

## 2. LITERATURE REVIEW

### **Perceived Social Status**

Perceived (subjective) social status is defined, in this study, as a person's belief about his location in a status order (Davis, 1956). In general, the social statuses of individuals are determined by wealth, consumption, or education relative to various reference standards (Tournemaine & Tsoukis, 2008). Driskell (1982) stated that people with higher status are given more chances to perform, initiate more interactions, receive more favorable evaluations of their actions, and are more likely to be influential in cases of disagreement. As a result, people strive to increase their social status, sometimes by using consumption.

### **Self-Esteem**

Self-esteem refers to how one assesses his/her self worth (Porter & Washington, 1993). An increase or decrease in self-esteem can lead to emotional reactions and certain kinds of behavior (Baumeister, Campbell, Krueger, & Vohs, 2005). Self-esteem can be studied at a group or an individual level (Porter & Washington, 1993). In this study, self-esteem is viewed at an individual level, and it consists of three underlying dimensions: appearance, performance, and social self-esteem (Heatheron & Polivy, 1991).

### **Conspicuous Consumption**

Conspicuous consumption is a type of consumption that takes place when consumers acquire goods not for their inherent objective or subjective value but instead to signal social status (Veblen, 1899). Consumers have information about the value of their assets in their minds, and they attempt to signal their wealth by consuming conspicuous goods (Bagwell & Bernheim, 1996; Amaldoss & Jain, 2005). The extant literature notes that conspicuous consumption takes place among people with various social statuses, regardless of their financial resources (Johansson-Stenman & Martinsson, 2006). People can signal their wealth by displaying products that are surrogates for income (Sivanathan & Pettit, 2010).

### **Saving Behavior**

Consumers can choose to consume now or delay their gratification and consume later. Saving behaviors take place when they choose to consume later in order to benefit from capital gains (Peek, 1983; Swasdpeera & Pandey, 2012). Based on a behavioral perspective, consumers save to respond to their behavioral limitations and incentives. The level of saving usually depends on the level of income (Dyanan, Skinner, & Zeldes, 2004). However, some consumers may choose to engage in conspicuous consumption to gain social capital at the cost of losing their savings (Moav & Neeman, 2012).

### **Hypothesis Development**

Conspicuous consumption can be considered a way of maintaining one's perceived social status (Souiden, M'Saad, & Pons, 2011). Consuming products that can portray a certain social status can make people feel more secure in belonging to that particular social class (O'Class & McEwen, 2004). People who display luxury brand labels are usually perceived as being wealthier, and they receive a higher status rating than those who do not display luxury brand labels (Nelissen & Meijers, 2011).

In addition, the study of the conspicuous consumption of branded fashion accessories in Canada has found a significant relationship between perceived social status and conspicuous consumption. People will conspicuously consumer a product when they seek to maintain their social status (Souiden, M'Saad, & Pons, 2011).

Based on the aforementioned argument, we formulate the following hypotheses:

H1: There is a relationship between perceived social status and conspicuous consumption.

Pettit and Sivanathan (2010) find that individuals with low self-esteem tend to purchase luxury products on credit to compensate for their self-worth. People attempt to make their self-identifies in line with the attributes deemed favorable within society (Leary & Kowalski, 1990). In addition, some groups of consumers may be more prone to conspicuous consumption. For instance, it is found that teenagers with low self-esteem are more likely to be materialistic and thus may be more engaged in the act of conspicuously consuming products (Chaplin & John, 2007).

In terms of cultural contexts, Souiden, M'Saad, and Pons (2011) find that the relationship between self-esteem and conspicuous consumption may vary across cultural settings. In some cultures, no significant relationship is found. In this study, we seek to examine such a relationship in the Thai context. Furthermore, we would like to determine which dimensions of self-esteem play a significant role in explaining conspicuous consumption. As a result, we postulate the following:

H2a: There is a relationship between performance self-esteem and conspicuous consumption.

H2b: There is a relationship between social self-esteem and conspicuous consumption.

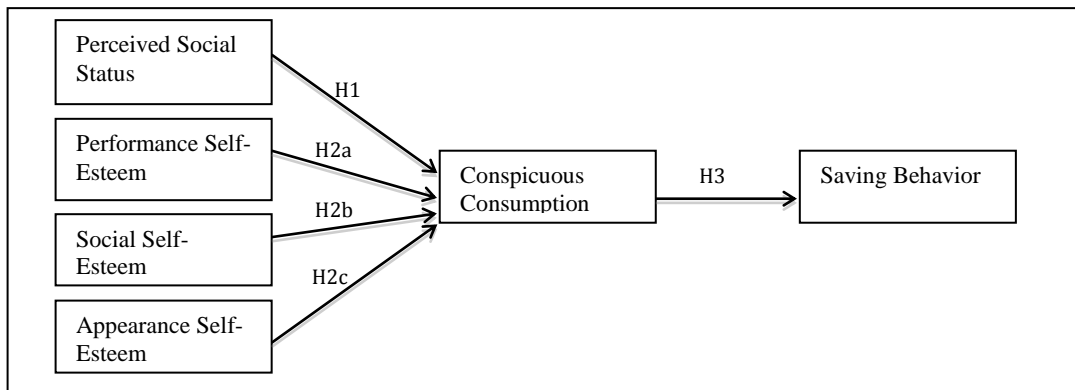
H2c: Appearance self-esteem negatively impacts conspicuous consumption.

According to Colarelli and Dettmann (2003), too much conspicuous consumption can lead to excessive spending, which eventually leads to debt. Pettit and Sivanathan (2010) found that conspicuous consumption and its accompanying debt played a critical role in crippling the global financial markets in 2008. Based on this argument, we hypothesize as follows:

H3: There is a relationship between conspicuous consumption and saving behavior.

Figure 1 conceptually links all the hypothesized relationships in this study. All relationships in this study are based mainly on the perception-behavior linkage within social psychology (Chartrand & Bargh, 1999; Dijksterhuis & van Knippenberg, 1998). In this study, perceived social status and self-esteem are considered perceptions that have an impact on conspicuous consumption and saving behaviors.

**Figure 1: Conceptual Framework**



### 3. METHODOLOGY

The data in this study were collected using an online survey and a convenience sampling technique. The respondents consisted of individuals who consume luxury goods and were aged between 20 and 60. Both men and women were included in this study, even though some studies indicate that woman may conspicuously consume products more often than men do (Stokburger-Sauer & Teichmann, 2013). The final sample size in this study is 266. Among respondents, 40.6% were men, and 59.4% were women. Their average age was 48.15, and their average monthly income was in the 50,000 to 150,000 Baht range. The majority of them (56 percent) hold a college degree.

In this study, perceived social status is measured using Cantril's (1965) 10-point scale item asking the respondents to rank where they stand on the social ladder (see the survey items of all key constructs in Appendix A). The respondents' level of self-esteem is measured using Heatherton and Polivy's (1991) 20-item scale. The measurement of conspicuous consumption is adapted from Chaudhuri, Mazumdar, and Ghoshal's scales published in 2011. Finally, saving behavior is based on the scale developed by the Bureau of Economic Analysis (BEA) (Bureau of Economic Analysis, 2012). Participants are asked to roughly estimate their level of monthly saving from a scale of 1 to 10.

The reliability of all measures, as well as their corresponding means, standard deviations, and correlations, are presented in Table 1. All measures in this study had a satisfactory level of internal consistency and reliability, with alpha coefficients above 0.70.

**Table 1: Cronbach's  $\alpha$  and Intercorrelations for Key Variables (N = 268)**

	1	2	3	4	5	6	Mean	SD	Cronbach's $\alpha$
1. Perceived Social Status	-						6.28	1.26	-
2. Self-Esteem (Performance)	.425**	-					36.71	5.87	0.81
3. Self-Esteem (Social)	.265**	.603**	-				32.49	7.35	0.80
4. Self-Esteem (Appearance)	.218**	.436**	.429**	-			28.71	5.55	0.76
5. Conspicuous Consumption	.234**	-.011	-.249**	-.049	-		43.59	18.01	0.93
6. Saving	.214**	.200**	.101	.141*	0.04	-	3.65	1.85	-

\*  $p < .05$ , \*\* $p < .01$

#### 4. FINDINGS AND DISCUSSION

Two regression models are used to test all hypotheses in this study. The first model is employed to test the relationships between perceived social status, self-esteem, and conspicuous consumption (H1, H2a-H2c), while the second model is used to examine the relationship between conspicuous consumption and saving behavior (See the summary in Table 2).

In the first model, all four predictor variables can explain 16.6% of the variance in conspicuous consumption ( $R^2 = .166$ ,  $p < .05$ ). Hypothesis 1 is supported because perceived social status is revealed to have a significant positive effect on conspicuous consumption ( $\beta = 0.265$ ,  $t = 4.26$ ,  $p < 0.01$ ). With regard to the relationships between the three sub-components of self-esteem and conspicuous consumption, only Hypothesis 2b is supported. No relationship is found between the appearance and performance dimensions of self-esteem and conspicuous consumption; only the social dimension of self-esteem is found to negatively affect conspicuous consumption (Beta = -0.228,  $t = -5.69$ ,  $p < 0.01$ ).

Here, the relationship between perceived social status and conspicuous consumption is consistent with the existing literature (Cole, Mailath, & Postlewaite, 1992; O'Class & McEwen, 2004; Souiden, M'Saad, & Pons, 2011). This means that people who consider themselves in a higher social stratification are more likely to use luxury products as a way to show off their social status.

The investigation of the relationship between each of the three sub-components of self-esteem and conspicuous consumption also yields an interesting finding. Thai consumers do not appear to conspicuously consume products because of their performance. They may be able to overcome their low performance esteem in some other way than consuming conspicuously. In terms of appearance self-esteem, the findings in this study show that Thai consumers do not consume conspicuously simply because they think they are not physically attractive. In other words, conspicuous buyers consume conspicuously regardless of how good they think their physical appearance is. The only dimension of self-esteem that has an impact on conspicuous consumption in the Thai setting is the social dimension. This means

that Thai people who feel socially inferior have a tendency to boost their social esteem by purchasing conspicuously.

Surprisingly, in the second regression model, we found no significant relationship between conspicuous consumption and saving behavior. It is still unclear why Thai consumers who engage in conspicuous consumption do not show a significantly lower level of saving. Future research should explore this phenomenon in depth.

**Table 2: Regression Analysis Summary (N = 268)**

Variable	<i>B</i>	<i>SEB</i>	$\beta$
<b>Model 1: Testing H1, H2a-H2c Predicting Conspicuous Consumption</b>			
Constant	36.03		
Perceived Social Status	3.871**	0.908	0.265
Performance Self-Esteem	0.325	0.236	0.105
Social Self-Esteem	-0.995**	0.175	-0.407
Appearance Self-Esteem	0.108	0.207	0.033
Note: $R^2 = .166$ ( $N = 268, p < .05$ ) $F = 13.09$ , * = $p < .05$ , ** $p < .01$			
<b>Model 2: Testing H3 Predicting Saving Behavior</b>			
Constant	3.471		
Conspicuous Consumption	0.004	0.006	0.04
Note: $R^2 = .001$ ( $N = 268$ ) $F = 2.75$			

In summary, conspicuous consumption is expected to be employed as a way of making consumers look good (appearance dimension), enhance the perception of their capabilities (performance dimension), allow them to achieve a sense of social belonging (social dimension), and eventually lead to a low level of savings or even debt. Thai consumers only conspicuously consume a product in order to feel that they belong to a particular social group. The appearance and performance dimensions of self-esteem appear to be of less concern among Thai consumers. No direct relationship is found between conspicuous consumption and saving behavior.

## 5. CONCLUSION AND SUGGESTIONS FOR FUTURE RESEARCH

We believe that this study is the very first study to specifically investigate the sub-components of self-esteem and their relationships with conspicuous consumption. In the Thai context, only the social sub-component of self-esteem is found to affect conspicuous consumption. It is suggested that future research treat the self-esteem construct both as an overall construct and as a three-component construct. This will provide a clearer picture of what component is critical in predicting conspicuous consumption among consumers.

This study also provides an important managerial implication because it sheds light on the importance of the sense of group belongingness to Thai consumers in relation to conspicuous consumption. Based on the results of this study, Thai consumers consume

conspicuously because they want to communicate their status to others. Companies should thus provide products that loudly proclaim the status of their holders to stimulate conspicuous consumption. The more obviously the product signifies belongingness to a social group, the more appealing such luxury brands become. Because Thai conspicuous consumers buy luxury goods conspicuously to enhance their social esteem, as opposed to gaining performance and appearance benefits from the products, marketers should communicate the social benefits associated with products in a subtle yet convincing manner.

Although the study has provided an overall picture of conspicuous consumption in Thailand, it focused on people who live in Bangkok. Future research should explore a sample from other geographical areas of the country. Future studies should also focus on comparing people with different demographic characteristics (e.g., gender) because these characteristics may affect the way they conspicuously consume.

Additionally, to better understand the relationship between conspicuous consumption and saving behavior, we should study both saving behavior and spending behavior in greater detail. This will help explain the findings of this study that are not in line with the literature.

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**THE ASSESSMENT OF CORPORATE GOVERNANCE PRACTICES  
DISCLOSURES AND TRANSPARENCY: A COMPARATIVE STUDY  
BETWEEN THE LISTED STATE-OWNED ENTERPRISES (SOEs)  
IN INDONESIA AND THAILAND**

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**ABSTRACT**

The aim of this study is to analyse the specific part of Good Corporate Governance (GCG) disclosures and transparency practices between Indonesia and Thailand's State-Owned Enterprises (SOEs) listed in the Indonesia Stock Exchange (IDX) and Stock Exchange of Thailand (SET) by applying the Asean Corporate Governance Scorecard (ACGS) with focus on the disclosure and transparency items. This study uses descriptive analysis approaches based on secondary data sources, namely the SOEs Annual Report in 2013 and the companies' website. The research framework tools used in this study was taken from the ASEAN Corporate Governance Scorecard (ACGS) which was initiated and developed by the ASEAN Capital Markets Forum (ACMF). It found that in general, Indonesia and Thailand SOEs have achieved a Good Corporate Governance (GCG) grades which score above 71 percent. Overall, Thailand listed SOEs have better performance againsts Indonesia listed SOEs. However, both countries shared the similar poorly experience in terms of implementation in the disclosure of information regarding the directors/commissioners dealings in shares of the company and the disclosure of external auditor and auditor reports' fees.

Key words: Corporate Governance, SOEs, ACGS, IDX, SET

# **THE ASSESSMENT OF CORPORATE GOVERNANCE PRACTICES DISCLOSURES AND TRANSPARENCY: A COMPARATIVE STUDY BETWEEN THE LISTED STATE-OWNED ENTERPRISES (SOEs) IN INDONESIA AND THAILAND**

## **1. INTRODUCTION**

Since the 1997 Asian Financial Crisis, a discussion of Corporate Governance (CG) has become a long way in the region. A wide range of laws and regulations have been enacted, standards developed and enforcement strengthened. A corporate governance infrastructure has been built, something that did not exist before the crisis. This infrastructure includes corporate governance committees, institutes of directors and many other institutions.

Important changes have also recently taken place in the organisation and corporate governance of State-Owned Enterprises (SOEs) in some Asian countries, including Indonesia and Thailand. These changes have been concentrated mainly in the areas of the ownership function and the legal and regulatory framework for SOEs (OECD, 2014).

Numerous regulations have been decreed and institutions have been established to monitor the implementation of Good Corporate Governance (GCG) in publicly SOEs and privately-owned enterprises as well as financial and non-financial companies. However, there have been quite few researchs and scholarly journals both from Indonesia and Thailand to analyse the CGC best practices of information disclosures from the listed SOEs in the Indonesia Stock Exchange (IDX) and Stock Exchange of Thailand (SET), especially to face and challenge to the Asean Economic Capital Market Unity within the Asean Economic Community (AEC) concept in the years to come.

This paper aims to compare and analyse the specific part of GCG disclosures and transparency practices between Indonesia and Thailand for their listed SOEs by applying the Asean Corporate Governance Scorecard which focus only on the disclosure and transparency items. The most reason chosen this objective is according to International Finance Corporation (IFC, 2014) the transparency and disclosure issues are amongst the most critical points in the SOEs operations and these remain challenging issues especially for the emerging countries.

## **2. LITERATURE REVIEW**

### **2.1 Corporate Governance (CG) Concept, Framework and General Principles**

According to Peng (2006) Corporate Governance (CG) is defined as the relationship amongst various participants in determining the direction and performance of corporation involving all corporate stakeholders, including shareholders, employees, customers, suppliers, creditors, government and the community. Furthermore, Steiner (2012) stated that CG is the exercise of authority over members of corporate community based on formal structures, rules and procedures. Lawrence and Weber (2014) solidified this term by declaring that CG refers to the process by which a corporation is controlled, or governed. Just as nations have governments that respond to the needs of citizens and establish policy,

so do corporations have systems of internal governance that determine overall strategic direction and balance sometimes divergent interests. Therefore, a Good Corporate Governance (GCG) refers to how a corporation is a well controlled and governed for the benefits of all its stakeholders.

OECD (2004) clarified that corporate governance is only part of the larger economic context in which firms operate that includes, for example, macroeconomic policies and the degree of competition in product and factor markets. The corporate governance framework also depends on the legal, regulatory, and institutional environment. In addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which a company operates can also have an impact on its reputation and its long-term success.

The OECD corporate governance framework is built on four core values (IFC, 2014), namely:

**Fairness:** The corporate governance framework should protect shareholder rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violations of their rights.

**Responsibility:** The corporate governance framework should recognize the rights of stakeholders as established by law, and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

**Transparency:** The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the company, including its financial situation, governance structure, performance and ownership.

**Accountability:** The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the Board, and the Board's accountability to the company and shareholders.

The General Principles of CG are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. The Principles focus on publicly traded companies, both financial and non-financial. However, to the extent they are deemed applicable, they might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state-owned enterprises (OECD, 2004).

The OECD Principles of CG – which are adopted and adapted by almost countries around the world with slight modifications, including ASEAN - are divided by six principles (OECD, 2004):

#### *1. Ensuring the Basis for an Effective Corporate Governance Framework*

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

## *2. The Rights of Shareholders and Key Ownership Function*

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

## *3. The Equitable Treatment of Shareholders*

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

## *4. The Role of Stakeholders in Corporate Governance*

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

## *5. Disclosure and Transparency*

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

## *6. The Responsibilities of the Board*

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

## **2.2 The Importance of Good Corporate Governance Implementation**

Good Corporate Governance is important on a number of different levels. At the company level, well-governed companies tend to have a better and cheaper access to capital, and tend to outperform their poorly governed peers over the long-term. Companies that insist upon the highest standards of governance reduce many of the risks inherent to an investment in a company. Companies that actively promote robust corporate governance practices need key employees who are willing and able to devise and implement good corporate governance policies. These companies will generally value and compensate such employees more than their competitors that are unaware of, or ignore, the benefits of these policies and practices. Such companies, in turn, tend to attract more investors who are willing to provide capital at lower cost.

Generally, well-governed companies are better contributors to the national economy and society. They tend to be healthier companies that add more value to shareholders, workers, communities, and countries in contrast with poorly governed companies that may cause job and pension losses, and even undermine confidence in securities markets (IFC, 2014).

## **2.3 Corporate Governance Framework in Indonesia: Development and Challenges**

In Indonesia, the financial crisis in 1997-1998 has had dramatic social, economic and political effects. That event brought the Rupiah currency down by almost 80 percent and dramatically increased poverty. The depth of the collapse in Indonesia, if not unparalleled, is among the largest peacetime contractions since at least 1960, excluding the experience of the

transition economies (IFC, 2014). According to several experts, the recession in Indonesia was fuelled by many institutional weaknesses, among which the lack or inadequate enforcement of the central bank's regulations along with irregular banking practices and the extremely poor financial regulation.

Since then, it is fair to say that, although there is still plenty of room for improvement, the awareness, enthusiasm as well as legal and regulatory framework on corporate governance in Indonesia has changed and improved dramatically in recent years.

Indonesia had done a lot of initiatives and efforts to implement good corporate governance, both from government side as well as private (IFC, 2014). Bapepam-LK, the securities regulator (currently has merged into the Financial Services Authority Agency – *Otoritas Jasa Keuangan/OJK*), has continued to introduce and amend its regulations, and has actively enforced these regulations to better protect investors. In 2006, Bank Indonesia introduced rules for corporate governance in banks, and has actively monitored and enforced their implementation. The Code of Good Corporate Governance (CGCG), first adopted in 1999, was amended in 2006, and sector specific codes issued for Banking and Insurance. In 2007 a new Company Law was adopted that introduced explicit duties for board members.

The Ministry of State Owned Enterprises has also carried out significant corporate governance reform in the State Owned Enterprise (SOE) sector. Basic shareholder rights are in place. Under recently revised Bapepam-LK regulation, nonconflicted shareholders approve certain related party transactions before they take place and the 2007 Company Law expanded shareholder rights to private redress. Regulatory requirements and private actions have improved board professionalism and company disclosure. The authorities have declared their intention to fully adopt international accounting and auditing standards. Companies produce relatively timely and complete reports. Boards of commissioners are more professional about their responsibilities, and have independent members. Many board members have received training on their duties and other areas (Worldbank, 2010).

Nevertheless, some challenges are still put in place. While the new Company Law has clarified the basic duties of board members, commissioners still do not carry out many key functions required by the OECD Principles of Corporate Governance, particularly the choice of CEO (president director). Board committees have permanent members who do not serve on either board tier, in part because commissioners are not believed to have sufficient technical skills. Besides that, minority shareholders have little influence on board member selection.

A key aspect of the audit framework — the selection of the external auditor — is not sufficiently clear in law or regulation. External auditors do not have a clear liability to shareholders or the company. Oversight of the accounting and auditing professions is shared among the self regulatory organizations, Bapepam-LK, and a division of the Ministry of Finance (MoF). In addition, the MoF has limited resources given the large number of public accounting firms and accountants.

A significant weakness is a lack of reporting of ultimate ownership and control, which hinders the effectiveness of rules on conflicts of interest. Shareholders also have limited rights to access other information from the company, like the articles of association, and many companies post little or no relevant information on their company websites. Mandatory corporate governance statements also tend to have limited content. While shareholder rights

are generally respected, shareholders have relatively weak rights to propose agenda items or ask questions. Rules on takeovers were changed in June 2008 and now require a higher threshold before a tender offer has to be made. Market participants have noted that these changes have made it difficult for large shareholders to accumulate shares and delist their companies from the exchange. While some of its provisions have been adopted into regulation, the CGCG is voluntary and companies do not have to “comply or explain” their adherence. This has reduced awareness of and compliance with the Code. Shareholders have made limited use of their redress rights under the law. Courts are slow, and few suits have been filed against companies or board members (Worldbank, 2010).

## **2.4 Corporate Governance Framework in Thailand: Development and Challenges**

Corporate governance reform has been a priority since the 1997 financial crisis and has continued up to present, with significant revisions to the Securities and Exchange Act 1992 (SEA), new Principles of Good Corporate Governance for listed companies, and a new banking act and supporting regulation to improve bank corporate governance. The amendments to the SEA included clearer duties for directors, stronger protection for shareholder rights, whistle blower protection, and provisions to increase the independence and professionalism of the Securities and Exchange Commission (SEC). The SEC has also increased direct oversight of auditors of listed companies, and local accounting standards are converging to International Financial Reporting Standards.

The SEC and Bank of Thailand (BoT) are well resourced and active in enforcing the various rules and requirements under their jurisdiction. The State Enterprise Policy Office (SEPO) has continued its efforts to improve the governance of state owned enterprises (SOEs), which include some of the largest listed companies. Thailand is also notable for a number of initiatives to improve corporate governance that go beyond legal or regulatory requirements. These include various programs of the Stock Exchange of Thailand and the Thai Associations of Listed Companies and Investors, and the work of the Thai Institute of Directors (Thai IoD). Thai IoD has been a pioneer in providing training to directors and through its Corporate Governance Report, introduced one of the first and most successful corporate governance scorecards in an emerging market economy.

Basic shareholder rights are well established, and shareholders freely trade their shares, participate in shareholders meetings—including by proxy—and receive a range of information from listed companies. They approve board members, dividends, major and related party transactions (RPTs), capital increases, and changes to the company’s articles, and have preemptive rights for new issues of shares. RPT rules require interested shareholders to recuse themselves from voting. Shareholders are to approve potential anti-takeover devices and receive tender offers from shareholders that acquire 25, 50, or 75 percent of shares. Insider trading is prohibited and other types of self-dealing and conflicts of interest are regulated. The SEC actively monitors the market for abusive practices. Institutional investors regularly vote their shares and some have issued voting policies and disclose their voting, as required by SEC regulations for asset managers. They occasionally vote against management. Companies produce complete audited annual reports largely consistent with international standards. These include disclosure of: industry and company trends and prospects; details on directors; risk and risk management; shareholdings of major shareholders and directors; details on RPTs; and statements on corporate governance and corporate social responsibility (CSR).

Information is available through company websites, and through the Department of Business Development, the company registrar in the Ministry of Commerce, both online and offline. Companies also pass on a range of material information to the SEC and SET, which is then posted on their websites. Most directors are non-executive, and typically at least one third are considered independent of management and major shareholders. Most boards also have separate chairs and CEOs. Duties of loyalty and care are found in the law and responsibilities are spelled out in the Principles and listing rules. These include oversight of management and strategy, approval of budgets and major expenditures, and ensuring that risk management and internal controls are established. In practice, directors take their responsibilities seriously. Directors participate in director training, and many undertake annual selfevaluations of their performance. The SEC screens directors of listed companies, and can disqualify them under the SEA. Directors and major shareholders in financial institutions must also pass a fit and proper test, and can be rejected and removed by the BoT. Guidelines for banks and other financial institutions have additional norms, including a risk committee for the board. Listed companies have audit committees of independent members, and many also have nomination and remuneration committees, as encouraged by the Principles. Companies also have internal audit functions that report to the audit committee and generally have internal control and risk management systems. Whistleblowers are legally protected (Worldbank, 2013).

While the underlying legislation is generally clear, it has been supplemented by a range of regulations and guidelines, many of which are still considered relevant or in force from several years before, even when more recent statements may cover the same ground. There is also potentially confusing differences and overlap between the SEA and Public Limited Company Act (PLCA). In spite of wide spread training and awareness raising, market participants may not always fully understand relevant parts of the corporate governance framework. While active enforcers, the response of the SEC and BoT to the global financial crisis has been limited, and they do not conduct joint inspections in spite of the growing importance of diversified financial companies to the Thai economy. The chair of the SEC recently resigned in scandal and neither the BoT nor the SEC are fully independent of the government and Ministry of Finance (MoF). The Ministry also exerts influence through SEPO. SOEs also still face a range of governance challenges including large numbers of civil servants on their boards. Line ministries combine *de facto* shareholder powers in SOEs with policy and sometimes regulatory functions for both SOEs as well as the private sector and lack guidance more generally on board appointment and other key shareholder functions.

Shareholders may receive as little as seven days notice for the GMS (general meeting of shareholders) and postal and electronic voting are not allowed. Foreign shareholders face limits on their participation in certain companies, and custodians do not have explicit requirements to act on their behalf. Minority shareholders have limited influence on actual board selection and high barriers to call a GMS, influence the meeting agenda, or bring legal action against the company or a director under the law.

Accounting standards still have some significant differences from international standards, particularly with respect to financial instruments. Owners and companies disclose direct shareholdings, but often do not disclose indirect control, or control held through custodians or shareholder agreements, in spite of SEC rules that imply they should. Independence requirements for auditors still allow for the provision of a range of non-audit services to clients, and, until recently, there was little oversight of audit quality or



independence. Other reputational agents also have limited requirements in terms of disclosing or managing conflicts of interest. SOEs are audited by the Office of Auditor General (OAG), a state auditor with limited capabilities to audit statements prepared in accordance with current accounting standards.

While board chair and CEO are generally not the same, the chairman is often not independent and may act as a “full-time” chair. Some market participants also question the effective independence of some long-tenured board members and SOE directors. In practice, the controlling shareholder still has great influence board selection. The controlling shareholder may also pick the CEO, which is not an explicit board power, and in turn some board members may see the interest of the company and the controlling shareholder as being largely the same thing (Worldbank, 2013).

## **2.5 State-Owned Enterprises: the Roles and Importance**

As providers of essential public or commercial services, state-owned enterprises (SOEs) still have important roles in modern economies (Efird, 2010). It is supported by the OECD (2005) reports that in several OECD countries, State-Owned Enterprises (SOEs) still represent a substantial part of GDP, employment and market capitalisation. Moreover, SOEs are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication. Those performance are of great importance to broad segments of the population and to other parts of the business sectors. Furthermore, the scale and scope of SOEs in many Asian economies calls for specific attention to be given to their corporate governance. Even if their economic significance varies greatly from country to country, they still represent a major, if not dominant, part of the economy in some countries (around 30% of GDP in China and 38% in Vietnam). SOEs remain significant in many other large and key Asian economies. In India and Thailand, for instance they roughly contribute 25 percent of the GDP, in Malaysia and Singapore close to 15 percent. SOEs might also represent a not insignificant part of total employment (15 percent in China, 5 percent in Malaysia) or of fiscal revenues (25-30 percent in Vietnam). Benefits from improving SOE governance are great, but they are difficult to obtain as SOE reforms can be complex and SOEs indeed face specific challenges in terms of governance (OECD, 2010).

In Indonesia, as it stated in Article 33 of the Constitution of the Republic of Indonesia, 1945 that all resources in the country shall be utilized for the economic advancement of all Indonesians. The constitution further prescribes that the government is responsible for ensuring that wealth is created and distributed throughout the nation. In response to the task, the Indonesian government has created, among other entities, various SOEs. According to Article 1 of the SOE Act (UU No. 19/2003/BUMN), the government must have at least 51% ownership in SOEs. The Act also states that the main objective of the SOEs is to gain profits by providing superior goods and services to customers and to spur economic growth and national prosperity (Yasin, M, 2013 and Warganegara, et al, 2013).

Based on the Indonesian economic performance, SOEs play a major role in the economy. In terms of their number, there are 141 SOEs actively engaged in the production of goods and services in the economy. According to SOEs Ministry (Yasin, M 2013), publicly listed SOEs in 2013 (20 SOEs listed company) had 26 percent of the total market capitalization of the Indonesia Stock Exchange. Furthermore, five of these SOEs belonged to the top ten firms with the highest market capitalization. In terms of total assets and revenues, the asset value owned by SOEs is 42 percent of the 2012 Indonesian Gross Domestic Product

(GDP) and the revenue is 19 percent of the GDP. Given the massive stake SOEs have in the economy, the Indonesian government must monitor the performance of its 141 SOEs closely. This may not be an easy task given their number, size, complexity, and the variety of industry types and geographic locations in which they operate.

Similar to global trends, Thai state-owned enterprises have operated as a state mechanism to provide essential services to citizens, such as utilities, infrastructure, and mass transportation. They have total assets of 5,519 billion baht (\$US137.05bn), or 85 percent of GDP, and an annual capital investment of 352 billion baht ((\$US8.74 bn), or 70 percent of government capital expenditure. Beginning in 2004, the Ministry of Finance implemented a corporate governance restructuring program to enhance the efficiency and effectiveness of Thai state-owned enterprises. So far, 53 of 58 Thai state-owned enterprises have restructured their corporate governance systems (Khongmalai, Tang and Siengthai, 2010).

Since the late 1990s, Thailand has committed itself to the privatization of some state-owned enterprises to improve efficiency and transparency. However, efforts at privatization have hit a wall given resistance from parts of civil society as well as entrenched, vested interests. Privatization has been further hindered given the political turmoil and the five changes in government since 2006. Some fear that further privatization, while improving market competitiveness, would also enable vested interests to gain controlling shares in important sectors. In fact, the state has enacted legislation forbidding the privatization of socially vital state enterprises (or those holding “commanding heights”) such as the Electricity Generating Authority of Thailand (EGAT) or the Water Works Authority (MWWA). As such, privatizations efforts such as those of the Port Authority of Thailand, the State Railway of Thailand, the national energy conglomerate PTT, Thai Airways International, the Airport Authority of Thailand (later renamed Airports of Thailand, or AOT), the BKS bus system, and the Mass Communication Organization of Thailand (MCOT) have all been stymied (BTI, 2014).

Based on the SET news, there are 15 SOEs and SOEs’ subsidiaries listed on the Stock Exchange of Thailand which constitute resources, services, financials, industrial and technology industrial sectors (SET, 2010).

## **2.6 CG Disclosures and Transparency: Implementation Challenges in SOEs**

According to IFC (2014), disclosure is defined as ensuring access to information for all interested parties, regardless of the purpose of obtaining the information, through a transparent procedure that guarantees information is easily found and obtained in timely manner. Timely and accurate disclosure is essential for shareholders, potential investors, regulatory authorities and other stakeholders. Access to material information helps shareholders protect their rights and improves the market participants’ ability to make sound economic decisions. Disclosure makes it possible to assess and oversee management, as well as to keep management accountable for the company and shareholders. Disclosure benefits companies since it allows them to demonstrate accountability towards shareholders, act transparently towards the markets, and maintain public confidence and trust. Good disclosure policies should also reduce the cost of capital. Finally, information is also useful for creditors, suppliers, customers and employees to assess their positions, respond to changes and shape their relations with companies.

In Indonesia, it is noted that transparency and disclosure issues are amongst the most critical points in the SOEs operation and these remain challenging issues although the Indonesian SOEs have been required to apply GCG in terms of transparency and disclosure. In the past, lack of transparency and disclosure was apparent. These days, efforts to create transparent SOEs seem to be everlasting homework for SOEs.

Information disclosure in SOEs is governed in Clause 32 of the Minister Regulation. This clause states “SOEs must disclose important information on its annual report and financial statements in accordance with the State laws and regulations not only in a timely manner but also in an accurate, clear and objective way”. While SOEs are required to be transparent they shall respect any confidential information. Unless otherwise provided by statutory provisions, the Articles of Association, and/or company rules the external auditors, internal auditors and the audit committee and other committees (if any), SOEs must keep confidential information obtained while performing their duties. Accordingly, it is the responsibility of both the Board of Directors (BOD) and Board of Commissioners (BOC) to maintain the confidentiality of company information.

The conflict between principles of transparency and disclosures and confidential information is considered the primary issue that the Indonesian SOEs shall take into account. Meanwhile, it is understood that there are no clear measures on the extent of transparency and confidentiality. This is coupled with the fact that the Indonesian SOEs are still reluctant in disclosing their financial statement. Hence, the number of SOEs which are listed in the stock exchange is low. Since the establishment of Indonesian Stock Exchange (previously Jakarta Stock Exchange) dating back 20 years ago, there have been only 20 SOEs listed.

While information disclosure has been clearly regulated under SOE Act, GCG Regulation and Act No. 14 Year 2008 concerning Public Information disclosure, there are no clear reasons upon the reluctance to exercise the transparency amongst the Indonesian SOEs. Many believe that lack of transparency seems to be an intentional agenda of political interest groups and bureaucrats. Hence, lack of transparency is linked to inefficiencies in the SOEs. One of the commonly noted cases is in the budgeting in procurement of Goods and Services. This is the fragile area where the lack of transparency entails to inefficiencies due to breach of integrity committed by the SOEs boards and personnel.

While a number of SOEs have performed well, it is noted that many of them are exposed to the alleged Breach of Integrity issue. In several SOEs, there is a resistance to commit to reforms, and often there are close ties between business and politics. Indeed, the integrity of SOEs personnel is still questionable. As widely known, a number of officials in a number of SOEs have been committed to and processed for breach of integrity allegations such as corruption and collusion. Hence, breach of integrity issues may be considered as the top challenge in SOEs operations. In the last 3 years, the Indonesian Corruption Eradication Commission (KPK) has processed quite a few numbers of the alleged cases (IFC, 2014).

Similar to Indonesia, as stated by Jongsureyapart (2006) a low transparency and the lack of disclosure were the two major problems of corporate governance implementation in Thailand.

According to the Thai Institute of Directors Report (2012), the disclosure of certain corporate information should be more encouraged. They are such as the basis of the board remuneration, a policy requiring directors to report transactions of the company's shares and

possible conflicts of interest, and contact information of the investor relations. The use of analysts and press briefings is also encouraged.

In view of transparency and disclosure issues, there is no quick fix to favor these in the SOE operation. Go Public can be one of the best ways where SOEs can exercise their transparency and disclosure initiative. However, the road to go there is quite stiff and there is always a need to have the right measures.

### 3. METHODOLOGY

This study uses descriptive analysis approaches based on secondary data sources, namely the SOEs Annual Report in 2013 and their company's website. In addition, the author chooses in a purpose all Indonesia's listed State-Owned Enterprises (SOEs) as well as all Thailand listed SOEs and subsidiaries as a sample research case study.

At the end of 2013, there were only 20 companies from 141 SOEs listed in Indonesia Stock Exchange (IDX) which representing variety of different sectors, including property and building constructions; mining; banking; consumer goods; basic industries and chemicals; and infrastructures, utilities and transportations with total assets was Rp 2.273.846 billion or US\$ 186,549 million. From the listing date data, it found that only four SOEs that listed in the IDX before Asian crisis in 1997, while the rest (16 SOEs) listed after 1997. The listed SOEs can be seen in the Table 1.

**Table 1: The Listed SOEs' Companies in the Indonesia Stock Exchange (2013)**

No	Industrial Sectors/SOEs Name	IDX Code	Total Assets (Rp Billion)	Total Assets (US\$ Million)	Listing Dated	Gov't Shares (%)
<b>A</b>	<b>Property and Building Constructions</b>					
1	PT Adhi Karya Tbk	ADHI	9,721	797	7 Nov 2003	51.00%
2	PT PP Tbk	PTPP	12,416	1,018	9 Feb 2010	51.00%
3	PT Wijaya Karya Tbk	WIKA	12,595	1,033	29 Oct 2007	65.15%
4	PT Waskita Karya Tbk	WSKT	8,788	721	17 Dec 2012	68.00%
<b>B</b>	<b>Mining</b>					
5	PT Aneka Tambang Tbk	ANTM	21,865	1,794	27 Nov 1997	65.00%
6	PT Bukit Asam Tbk	PTBA	11,677	958	23 Dec 2002	65.02%
7	PT Timah Tbk	TINS	7,883	647	27 Sep 1995	60.00%
<b>C</b>	<b>Banking</b>					
8	PT Bank BNI Tbk	BBNI	386,655	31,722	Nov 1996	60.00%
9	PT Bank BRI Tbk	BBRI	626,183	51,373	10 Nov 2003	56.75%
10	PT Bank BTN Tbk	BBTN	131,170	10,761	17 Dec 2009	60.14%
11	PT Bank Mandiri Tbk	BMRI	733,100	60,144	14 Jul 2003	60.00%
<b>D</b>	<b>Consumers Goods</b>					
12	PT Kimia Farma Tbk	KAEF	2,472	203	4 Jul 2001	90.03%
13	PT Indo Farma Tbk	INAF	1,337	110	17 Apr 2001	80.66%
<b>E</b>	<b>Basic Industry &amp; Chemicals</b>					
14	PT Krakatau Steel Tbk	KRAS	29,004	2,379	10 Nov 2010	80.00%
15	PT Semen Baturaja Tbk	SMBR	2,711	222	28 Jun 2013	76.23%
16	PT Semen Indonesia TBK	SMGR	30,793	2,526	4 Jul 1991	51.01%
<b>F</b>	<b>Infrastructures, Utilities &amp; Transportation</b>					
17	PT Garuda Indonesia Tbk	GIAA	36,004	2,954	11 Feb 2011	69.14%
18	PT Jasa Marga Tbk	JSMR	28,366	2,327	1 Nov 2007	70.00%
19	PT Gas Negara Tbk	PGAS	53,183	4,363	15 Dec 2003	56.97%
20	PT Telekomunikasi Indonesia Tbk	TLKM	127,951	10,497	14 Nov 1995	53.14%
			<b>2,273,846</b>	<b>186,549</b>		

Sources: Companies Annual Report 2013 and Websites

As the same its counterpart, at the end of 2013, there were only 15 companies (including the SOEs' subsidiaries) from 58 SOEs listed in Stock Exchange of Thailand (SET) which representing variety of different sectors, including resources, services, financials, industrial and technology with total assets was Thai Baht 6,717,709 million or US\$ 205,180 million. In Thailand, there were six SOEs which listed in SET before 1997, while the rest (nine SOEs) listed more recently after the Asian crisis. In addition, only five SOEs that directly have shareholders owned by the Thai Government (Ministry of Finance), they are AOT, THAI, MCOT, KTB and PTT. For the rest (10 companies) were owned by the SOEs company as the company's subsidiaries. The listed Thailand SOEs and subsidiaries can be seen in the next table.

**Table 2: The Listed SOEs' Companies and Subsidiaries in the Stock Exchange of Thailand (SET) as of 31 December 2013**

No	Industrial Sectors/SOEs Name	SET Code	Total Assets (Million Baht)	Total Assets (US\$ Million)	Listing Dated	Gov't Shares (%)
<b>A Services/transportation &amp; logistics</b>						
1	Airports of Thailand Plc	AOT	153,061	4,675	11 Mar 2004	70.00% (MOF)
2	Thai Airways Int'l Plc	THAI	307,085	9,379	19 Jul 1991	51.03% (MOF)
3	Bangkok Metro Plc	BMCL	20,359	622	21 Sep 2006	14.57% (MRTA)
<b>B Services/media &amp; publishing</b>						
4	MCOT Plc	MCOT	11,168	341	17 Nov 2004	65.80% (MOF)
<b>C Financials/banking</b>						
5	KrungThai Bank Plc	KTB	2,514,771	76,809	2 Aug 1989	55.05% (FIDF)
<b>D Resources/energy utilities</b>						
6	PTT Plc	PTT	1,801,722	55,030	6 Dec 2001	65.29% (MOF)
7	Bang Chak Petroleum Plc	BCP	72,389	2,211	2 Aug 1994	27.22% (PTT); 9.98% (MOF)
8	Electricity Generating Plc	EGCO	130,937	3,999	16 Jan 1995	25.41% (EGAT)
9	IRPC Plc	IRPC	162,668	4,968	17 Mar 1995	38.51% (PTT); 9.65% (GSB); 5.79% (GPF)
10	PTT Exploration & Production Plc	PPTEP	707,867	21,620	10 Jun 1993	65.29% (PTT)
11	Ratchaburi Electricity Generating Holding Plc	RATCH	88,903	2,715	2 Nov 2000	45.00% (EGAT)
12	Thai Oil Plc	TOP	208,519	6,369	26 Oct 2004	49.10% (PTT)
<b>E Industrial/petrochemicals &amp; chemicals</b>						
13	PTT Global Chemical Plc	PTTGC	432,362	13,206	19 Oct 2011	48.89% (PTT)
<b>F Technology/Information Communication &amp; Technology</b>						
14	Total Access Communication Plc	DTAC	105,054	3,209	22 Jun 2007	5.6% (TOT)
15	Internet Thailand Plc	INET	844	26	14 Nov 2001	16% (TOT); 17% (NSTDA); 16% (CAT)
			<b>6,717,709</b>	<b>205,180</b>		

Sources: Companies Annual Report 2013 and SET Websites

### 3.1 Research Framework Tools

The research framework tools used in this study was taken from the ASEAN Corporate Governance Scorecard (ACGS) which was initiated and developed by the ASEAN Capital Markets Forum (ACMF, 2011). This initiative is undertaken in parallel with the efforts to achieve convergence in ASEAN countries by 2015 as an economic community. Broadly the ACMF Implementation Plan seeks to achieve the objectives of the ASEAN Economic Community (AEC) aspirations through the following areas (ACMF, 2011):

- Creating an enabling environment for regional integration
- Creating the market infrastructure and regionally focused products and intermediaries
- Strengthening the implementation process
- Enhancing the visibility, integrity and branding of ASEAN as an asset class
- In line with the AEC issues, therefore, the objectives of the ACGS are to (ACMF, 2011):
- Raise corporate governance standards and practices of ASEAN Public Listed Companies (PLCs)
- Showcase and enhance the visibility as well as investability of well-governed ASEAN PLCs internationally
- Complement the other ACMF initiatives and promote ASEAN as an asset class

The ACGS covers the following five areas of the OECD Principles, namely: (1) Rights of shareholders; (2). Equitable treatment of shareholders; (3). Role of stakeholders; (4). Disclosure and transparency; (5) Responsibilities of the board. However, because of the limitation of the study and the crucial point of the Disclosure and Transparency (D & T) issues which was proposed by the IFC (2014), the author only applies the Disclosure and Transparency focus area for this study.

The disclosure and transparency area of the ACGS has nine subjects analysis which is divided by 41 focus items (ACMF, 2011). The details of the ACGS on the Disclosure and Transparency Area can be seen in the Appendix 1. Each item is marked by one point; after that is summed to get the total mark. The final percentage score is calculated by dividing the total mark with total items of disclosure and transparency area i.e 41 and multiply by 100%. Then, every SOEs listed's final score is ranked by using of the grade scale percentage criterias, as follows:

**Table 3: Disclosure and Transparency (D&T) CG Scores Grading Range**

Final Score (%)	CG Grades	Comments
≤ 60	Poorly Disclosure	Lack of disclosure and transparency in most items. It needs radical and major improvements changes
61 – 70	Satisfactory Disclosure	Only fulfilled minimum requirements of disclosure and transparency items. It needs medium to major improvements
71 – 80	Good Disclosure	Fulfilled majority of disclosure and transparency items with needs minor improvements
81 – 90	Very Good Disclosure	Fulfilled most of disclosure and transparency items
91 – 100	Excellent Disclosure	Fullfilled all of disclosure and transparency items

Source: ACMF (2011)

#### 4. FINDINGS AND DISCUSSION

Overall, in terms of the D & T implementation, both nations have achieved a good Corporate Governance (CG) grades (above 71 percent). However, Thailand listed SOEs have outperformed against Indonesia listed SOEs, where Thailand SOEs achieved a very good CG disclosure grades (at 84 percent) while Indonesia SOEs has only reached to a good CG grade (at 72 percent). Thailand SOEs has succeeded achieve seven D & T subjects which qualifying a very good and excellent D & T CG grade (above 81 percent); while Indonesia SOEs only achieved four D & T subjects with the similar CG grades qualification. It is one of indication that the D & T CG implementation in Thailand much more well a head compared to Indonesia.

Nevertheless, both countries shared the similar poorly experience in terms of implementation in the disclosure of information regarding the directors/commissioners dealings in shares of the company which results only eight and seven percent, respectively; as well as the disclosure of external auditor and auditor reports which only achieve 19 and 29 percent, respectively. These two items should have more pay attentions and need a major change improvements by the SOEs listed in both nations. In addition, for Indonesia SOEs, there was another one subject should be taken into account, namely disclosure of Related Party Transaction (RPTs) which obtain a poor D & T CG grades. The details comparison figures from both countries can be seen in the Table 4.

**Table 4: Comparison D & T Scores Percentage, Indonesia & Thailand SOEs Performance**

No	Disclosure and Transparency (D&T) Subject	Indonesia SOEs		Thailand SOEs	
		Total Avg. Score	%	Total Avg. Score	%
I	Transparent ownership structure (5 items)	3.78	76%	4.90	98%
II	Quality of Annual Report (12 items)	10.71	89%	10.50	88%
III	Disclosure of related party transactions (RPT) - 3 items	0.33	11%	2.47	82%
IV	Directors and commissioners dealings in shares of the company (1 item)	0.01	8%	0.07	7%
V	External Auditor and Auditor Report (3 items)	0.58	19%	0.87	29%
VI	Medium of communications (4 items)	3.45	86%	3.80	95%
VII	Timely filing/release of annual/financial reports (3 items)	3.00	100%	3.00	100%
VIII	Company website (9 items)	6.86	76%	8.07	90%
IX	Investor relations (1 item)	0.91	91%	0.91	91%
	<b>TOTAL SCORES</b>	<b>29.68</b>	<b>72%</b>	<b>34.58</b>	<b>84%</b>

Sources: ACMF (2011), SOEs Annual Report (2013) and SOEs website (processed)

In analysing D & T grades by industrial sectors, it clears that banking sectors have the highest CG grades for Indonesia and Thailand by 79 and 88 percent, respectively. It is proven that banking sectors in both countries have more advance compare its counterparts due to the applying of stiff rules and regulations by the regulator.



In Indonesia, the property, building and constructions has placed second of D & T grades at 76 percent, followed by mining, infrastructures and industry sectors by 74 percent, 72 percent and 67 percent, respectively. Consumers goods sector has experienced as the lowest D & T grades which only achieved below 60 percent or poorly CG disclosure. Interestingly enough, however, most sectors have poorly D & T grades (below 60 percent) in three items, i.e: disclosure of RPTs, directors and commissioners dealings in shares of the company and external auditor and auditor reports.

The following table (Table 5) explains more figures which related to D & T scores result by industrial sectors in Indonesia.

**Tabel 5: D & T Scores Results (%) by Industrial Sectors (Indonesia SOEs)**

No	Disclosure and Transparency (D&T) Subject	Property, Building Constructions	Mining	Banking	Infrastructure, Utilities & Transportation	Consumer Goods	Basic Industry & Chemicals
I	Transparent ownership structure (5 items)	75%	77%	85%	70%	70%	73%
II	Quality of Annual Report (12 items)	94%	94%	95%	87%	76%	84%
III	Disclosure of related party transactions (RPT) - 3 items	21%	11%	17%	11%	0%	0%
IV	Directors and commissioners dealings in shares of the company (1 item)	25%	16%	0%	0%	0%	0%
V	External auditor and Auditor Report (3 items)	21%	11%	17%	75%	0%	22%
VI	Medium of communications (4 items)	100%	100%	100%	81%	50%	67%
VII	Timely filing/release of annual/financial reports (3 items)	100%	100%	100%	100%	100%	100%
VIII	Company website (9 items)	75%	67%	86%	81%	67%	74%
IX	Investor relations (1 item)	92%	100%	100%	100%	50%	83%
	<b>TOTAL SCORES (%)</b>	<b>76%</b>	<b>74%</b>	<b>79%</b>	<b>72%</b>	<b>59%</b>	<b>67%</b>

Sources: ACMF (2011), SOEs Annual Report (2013) and SOEs website (processed)

In Thailand, all sectors achieved a good and very good D & T disclosure grades. Even the media and publishing sector has reached the similar D & T grade with the banking sector i.e at 88 percent. Followed by resources, energy and utilities; technology; industry; and services, transportation and logistics sectors by 87, 83, 81 and 79 percent, respectively. A quite similar with Indonesia's counterparts, nevertheless, all Thailand listed SOEs have poorly D & T grades in directors and commissioners dealing in shares of the company as well as the external auditor and auditor report subjects.

The next table (Table 6) explain more figures which related to D & T scores result by industrial sectors in Thailand.



**Table 6: D & T Scores Results (%) by Industrial Sectors (Thailand SOEs)**

No	Disclosure and Transparency (D&T) Subject	Services/ transportation & logistics	Services/ media & publishing	Finance/ Banking	Resources/ energy & utilities	Industrial/ petrochemical & chemicals	Technology (ICT)
I	Transparent ownership structure (5 items)	90%	100%	100%	100%	100%	100%
II	Quality of Annual Report (12 items)	87%	92%	92%	90%	79%	83%
III	Disclosure of related party transactions (RPT) - 3 items	57%	67%	67%	90%	100%	100%
IV	Directors and commissioners dealings in shares of the company (1 item)	0%	33%	0%	0%	0%	0%
V	External auditor and Auditor Report (3 items)	11%	33%	33%	29%	17%	33%
VI	Medium of communications (4 items)	92%	100%	100%	100%	88%	75%
VII	Timely filing/release of annual/financial reports (3 items)	100%	100%	100%	100%	100%	100%
VIII	Company website (9 items)	89%	89%	78%	92%	89%	89%
IX	Investor relations (1 item)	83%	100%	100%	95%	75%	100%
	<b>TOTAL SCORES (%)</b>	<b>79%</b>	<b>88%</b>	<b>88%</b>	<b>87%</b>	<b>81%</b>	<b>83%</b>

Sources: ACMF (2011), SOEs Annual Report (2013) and SOEs website (processed)

Therefore, for all industrial sectors in both nations, the areas which should be disclosed and improved in the immediate terms which have the lowest D & T grades are the disclosure of information regarding the directors/commissioners dealing in shares of the company and the disclosures of external auditor and auditor report fees. Especially for Indonesia, other major D & T items which need major improvements is the disclosure of related party transactions.

From the individual listed SOEs analysis comparison in both countries, Thailand's Electricity Generating Plc (EGCO) placed the highest D & T grades at 95 percent, the only one SOE company that achieved excellent disclosure. In general, individually, Thailand listed SOEs have better D & T grades compared its counterparts by placing 11 companies in a very good disclosure and three companies in a good disclosure ranges, and none in the satisfactory and poorly disclosure ranges.

In the second D & T grades range (a very good disclosure), Thailand posted 11 SOEs companies, namely KTB (88 percent), MCOT (88 percent), PTTEP (88 percent), THAI (88 percent), BCP (88 percent), IRPC (85 percent), RATCH (85 percent), TOP (85 percent), PTTGC (83 percent), PTT (82 percent) and DTAC (81 percent), respectively. Meanwhile,

Indonesia placed three SOEs companies, they are PTPP (84 percent), ANTM (82 percent) and BBRI (82 percent), respectively.

**Tabel 7: Comparison D & T Percentage by SOEs company (Indonesia & Thailand)**

Indonesia SOEs	D & T Grades (%)	Thailand SOEs
None	Excellent Disclosure (91-100)%	EGCO (95%)
PTPP (84%) ANTM (82%) BBRI (82%)	Very Good Disclosure (81-90)%	KTB (88%) MCOT (88%) PTTEP (88%) THAI (88%) BCP (88%) IRPC (85%) RATCH (85%) TOP (85%) PTTGC (83%) PTT (82%) DTAC (81%)
WIKA (80%) SMGR (80%) TLKM (80%) BMRI (79%) BBTN (78%) BBNI (76%) JSMR (73%) PGAS (73%) ADHI (72%) PTBA (72%)	Good Disclosure (71-80)%	INET (80%) BMCL (78%) AOT (71%)
TINS (67%) WSKT (66%) SMBR (63%) GIAA (63%)	Satisfactory Disclosure (61-70)%	None
KAEF (60%) KRAS (59%) INAF (57%)	Poorly Disclosure (≤ 60%)	None

Sources: ACMF (2011), SOEs Annual Report (2013) and SOEs website (processed)

In the third D & T grades range (a good disclosure), Indonesia posted 10 SOEs companies, namely WIKA (80 percent), SMGR (80 percent), TLKM (80 percent), BMRI (79 percent), BBTN (78 percent), BBNI (76 percent), JSMR (73 percent), PGAS (73 percent), ADHI (72 percent), and PTBA (72 percent), respectively. Meanwhile, Thailand placed three SOEs companies, they are INET (80 percent), BMCL (78 percent) and AOT (71 percent), respectively.

The lowest three D & T scorers (poorly disclosure) from Indonesia SOEs were placed by INAF at 57 percent followed by KRAS at 59 percent and KAEF at 60 percent, respectively. Lack of or no disclosure information regarding to the related party transactions, the directors/commissioners dealings in shares of the company and the external auditor fees report are the three most factors which make the lowest overall scores of the D & T items. The Table 7 describes the details of each listed SOEs CG scores percentage in Indonesia and Thailand.

## 5. CONCLUSION

The Corporate Governance (CG) issues have become hot topic discussions since the last decade by both academician scholars as well as business people across the globe. In ASEAN countries, this issue has obtained more attention, especially after the economic crisis hit this region in the end of 1990s. Every country, including Indonesia and Thailand has promoted the CG regulations and legal framework to implement the best GCG in the company's operations and performance.

To face and challenge the AEC by 2015, the ACMF has released the ACG Scorecard which is recommended used by all public listed companies within this ASEAN region. For the study objective, the D & T items were chosen in a purpose to analyse the listed SOEs performance against the ACG scorecards in Indonesia and Thailand.

It found that in general, Indonesia and Thailand SOEs have achieved a good Corporate Governance (CG) grades (above 71 percent). However, Thailand listed SOEs have better performance against Indonesia listed SOEs, where Thailand SOEs achieved a very good CG disclosure grades (at 84 percent) while Indonesia SOEs has only reached to a good CG grade (at 72 percent). It signs that the D & T CG implementation in Thailand much more well a head compared to Indonesia. In other words, Thailand listed SOEs much more ready to face the AEC integration challenge in the years to come.

Notwithstanding, both countries shared the similar poorly experience in terms of implementation in the disclosure of information regarding the directors/commissioners dealings in shares of the company as well as the disclosure of external auditor and auditor reports. Therefore, it is recommended, these two items should have more pay attentions and need a major change improvements by the SOEs listed in both nations. For Indonesia SOEs, another subject that should be taken into account, is a disclosure of Related Party Transaction (RPTs) which obtain a poor D & T CG grades.

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## APPENDIX

### Appendix 1: ASEAN Corporate Governance Scorecard Items – Part D. The Disclosure and Transparency

<b>D. Disclosure and Transparency (41 items)</b>
<b>D.1 Transparent ownership structure (5 items)</b>
D.1.1 Does the information on shareholdings reveal the identity of beneficial owners, holding 5% shareholding or more?
D.1.2 Does the company disclose the direct and indirect (deemed) shareholdings of major and/or substantial shareholders?
D.1.3 Does the company disclose the direct and indirect (deemed) shareholdings of directors (commissioners)?
D.1.4 Does the company disclose the direct and indirect (deemed) shareholdings of senior management?
D.1.5 Does the company disclose details of the parent/holding company, subsidiaries, associates, joint ventures and special purpose enterprises/ vehicles (SPEs)/ (SPVs)?
<b>D.2 Quality of Annual Report (12 items)</b>
Does the company's annual report disclose the following items:
D.2.1 Key risks
D.2.2 Corporate objectives
D.2.3 Financial performance indicators
D.2.4 Non-financial performance indicators
D.2.5 Dividend policy
D.2.6 Details of whistle-blowing policy
D.2.7 Biographical details (at least age, qualifications, date of first appointment, relevant experience, and any other directorships of listed companies) of directors/commissioners
D.2.8 Training and/or continuing education programme attended by each director/commissioner
D.2.9 Number of board of directors/commissioners meetings held during the year
D.2.10 Attendance details of each director/commissioner in respect of meetings held
D.2.11 Details of remuneration of the CEO and each member of the board of directors/commissioners
D.2.12 Does the Annual Report contain a statement confirming the company's full compliance with the code of corporate governance and where there is non-compliance, identify and explain reasons for each such issue?
<b>D.3. Disclosure of related party transactions (RPT) - 3 items</b>
D.3.1 Does the company disclose its policy covering the review and approval of material/significant RPTs?
D.3.2 Does the company disclose the name of the related party and relationship for each material/significant RPT?
D.3.3 Does the company disclose the nature and value for each material/significant RPT?
<b>D.4 Directors and commissioners dealings in shares of the company (1 item)</b>
D.4.1 Does the company disclose trading in the company's shares by insiders?

<b>D.5 External auditor and Auditor Report (3 items)</b>
D.5.1 Are audit fees disclosed?
Where the same audit firm is engaged for both audit and non-audit services,
D.5.2 Are the non-audit fees disclosed?
D.5.3 Does the non-audit fees exceed the audit fees?
<b>D.6 Medium of communications (4 items)</b>
Does the company use the following modes of communication?
D.6.1 Quarterly reporting
D.6.2 Company website
D.6.3 Analyst's briefing
D.6.4 Media briefings /press conferences
<b>D.7 Timely filing/release of annual/financial reports (3 items)</b>
D.7.1 Is the audited annual financial report released within 120 days from the financial year end?
D.7.2 Is the audited annual financial report released within 90 days from the financial year end?
D.7.3 Is the true and fairness/fair representation of the annual financial statement/reports affirmed by the board of directors/commissioners and/or the relevant officers of the company?
<b>D.8 Company website (9 items)</b>
Does the company have a website disclosing up-to-date information on the following:
D.8.1 Business operations
D.8.2 Financial statements/reports (current and prior years)
D.8.3 Materials provided in briefings to analysts and media
D.8.4 Shareholding structure
D.8.5 Group corporate structure
D.8.6 Downloadable annual report
D.8.7 Notice of AGM and/or EGM
D.8.8 Company's constitution (company's by-laws, memorandum and articles of association)
D.8.9 All of the above (D.8.1 to D.8.8) are available in English
<b>D.9 Investor relations (1 item)</b>
D.9.1 Does the company disclose the contact details (e.g. telephone, fax, and email) of the officer responsible for investor relations?

# **CAPITAL STRUCTURE DECISIONS AND THEIR IMPACT ON PERFORMANCE OF COMPANIES**

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## **ABSTRACT**

Companies need funds for their smooth operations. Capital structure of a company is the quantitative composition of different types of financing for such funds for the company's operations and growth. The two main categories of financing are equity and debt. Equity can be classified as common stock, preferred stock and retained earnings. Debt comes in the form of bonds and long term notes payable. Each category has its own advantages and disadvantages. Capital structure differs from financial structure, as the latter includes short-term debt, accounts payable and other liabilities. The ratio of debt to the total financing is called financial leverage, which affects the profits and value of a firm and at higher levels may expose it to risks of financial distress and bankruptcy.

Many theories and theorems have been proposed to determine the capital structure decisions. Though it has been proved irrelevant in a perfect market, the imperfections existing in the real world are the cause for relevance of capital structure for the financial health of a company. The present study aims at an extensive search of literature on the subject of capital structure, select a few companies in the real business world with a special attention to the secondary data on their capital structures, bring out the existence and magnitude of the effect of their capital structures on the their value and returns on investments and then draw some valid conclusions for universal application on capital structures to suit the survival, growth and development needs of companies.

**Keywords:** Capital Structure, Debt, Equity, Financial Leverage, Types of Financing



# CAPITAL STRUCTURE DECISIONS AND THEIR IMPACT ON PERFORMANCE OF COMPANIES

*"If you don't drive your business, you will be driven out of business."- B. C. Forbes*



*Source: Web Search for Image of Capital Structure*

## 1. OVERVIEW OF CAPITAL STRUCTURE & CORPORATE FINANCE

### Meaning of relevant technical terms

**Financial Structure:** It is the relative proportion of various sources of funds used in a business.

**Capital Structure:** Capital structure is a part of financial structure and is the mix of different categories of financial capital that a corporation, partnership, or other economic entity raises as long-term capital and utilizes to conduct its operations. It is the way a corporation finances its assets through some combination of equity, debt or hybrid securities. In other words, a firm's capital structure is the composition or structure of its liabilities. It is the permanent financing of a firm represented by long-term debt, preferred stock (preference share capital) and net worth (shareholders' funds) and excludes short-term borrowings.

### Various Definitions of Capital Structure:

- The quantitative composition or make up of a firm's capitalization, including all long term capital resources, like loans, reserves, shares and bonds (Gerestenberg).
- Balancing the array of fund sources in a proper manner, i.e. in relative magnitude or in proportions (Keown et al)
- Essentially concerned with how a firm decides to divide its cash flows into two broad components, a fixed component earmarked to meet the obligations toward debt capital and a residual component belonging to equity shareholders (P.Chandra)

**Patterns of Capital Structure:** A complex capital structure pattern of an established firm may be of following forms: 1. Equity Shares and Debentures, 2. Equity Shares and Preference Shares, and 3. Equity Shares, Preference Shares and Debentures. However, irrespective of the pattern of the capital structure, a firm must try to maximize the earnings per share for the equity shareholders and also the value of the firm.

**Value of a Firm:** The sum of market values of outstanding debts and equity of a firm.

**Leverage/Gearing:** It represents the proportion of a firm's capital that is obtained through debt (either bank loans or bonds).

**Perfect Capital Market:** It is a capital market characterized by no transaction or bankruptcy costs, perfect information, same interest rate for firms and individuals, no corporate income taxes, and investment returns not affected by financial uncertainties. As can be expected, it is an imaginary, non-existent or theoretical market.

**Real World Capital Market:** A real world capital market has all the imperfections and is devoid of all the characteristics of a perfect market. The assumptions made for a perfect market have to be relaxed and modified in the form of various theories and hypotheses to address the imperfections of the real market.

**Corporate Finance:** It is the area of finance dealing with the sources of funding and the capital structure of corporations and the actions that managers take to increase the value of the firm to the shareholders, as well as the tools and analysis used to allocate financial resources. The primary goal of corporate finance is to maximize or increase shareholder value.

### **Capital structure decisions**

Capital structure decision is a decision about the proportion among the different kinds of securities raised by an enterprise as long-term finance and involves: A.) Type of securities to be issued: equity shares, preference shares and long term borrowings (Debentures) and B.) Relative ratio of securities determined by the process of capital gearing. On this basis, companies are divided into two: 1. Highly Geared Companies, with a small proportion of equity capitalization, and 2. Low Geared Companies, with equity capital dominating total capitalization. Such decisions can affect the value of a firm either by changing the expected earnings or the cost of capital or both. An optimum capital structure would be obtained at that combination of debt and equity that maximizes the total value of the firm (value of shares plus value of debt) or minimizes the weighted average cost of capital. Getting the capital structure designed in the most optimal way can mean the difference between success and failure of a business entity. Such decisions relating to financing the assets of a firm are very crucial in every business and the finance manager is often caught in the dilemma of what the optimum proportion of debt and equity should be. As a general rule there should be a proper mix of debt and equity capital in financing the firm's assets. Capital structure is usually designed to serve the interest of the equity shareholders.

### **Properly Designed Capital structure & its Importance**

To remain debt-free may be the goal of life in the lower echelons of finance, but in the higher echelons that idea is almost anathema. Many of the most successful companies in the world base their capital structure on one simple consideration, the cost of capital. The proportion of debt in the capital structure depends on the security of revenue generation of the business. Great managers attempt at consistently lowering the weighted average cost of capital of their business by increasing productivity, seeking out higher return products, and other means. To truly understand the idea of capital structure, it is important to understand that the capital structure represents one of the three components in determining the rate of

return a company will earn on the money its owners have invested in it. The main objectives of capital structure decision are:

- A.) Value Maximization: Market value of the firm is maximized.
- B.) Cost Minimization: A proper mix of fund sources minimizes the overall cost of capital.
- C.) Increase in Share Price: Increase in 'earnings per share' (**E.P.S.**) and in shareholders' dividend.
- D.) Investment Opportunity: Company's ability to find new wealth creating opportunities & increase in debtor's confidence.
- E.) Growth of the Country: Increase in company's wealth creation leads to country's growth.

### **Sources of Capital:**

Broadly speaking, there are two forms of capital: equity capital and debt capital, each with its own benefits and drawbacks. A substantial part of wise corporate management is in attempting to find the perfect capital structure mix in terms of risk / reward payoff for shareholders.

1. Equity Capital: Corporations can sell shares of the company to investors to raise capital. Investors buy shares expecting to make their investment to be a profitable purchase. It consists of two types: A) contributed capital, the money originally invested in the business in exchange for shares of stock or ownership, and B) retained earnings, the profits from past years kept by the company to strengthen the balance sheet, fund growth, acquisitions, or expansion. Shareholder value and market value of stock is increased when corporations invest equity capital and other funds into projects that earn a positive rate of return in the future. It may also be increased when corporations payout excess cash from retained earnings that are not needed for business in the form of dividends. Equity capital is considered by many to be the most expensive type of capital a company can utilize, because its "cost" is the return the firm must earn to attract investment.

2. Debt Capital or Credit: It refers to borrowed money that is at work in the business. It comes in several forms, like bank loans, notes payable and bonds issued to the public. The safest type is generally considered long-term bonds, because the company has years, if not decades, to come up with the principal, while paying interest only in the meantime. Other types include short-term commercial paper utilized by giant companies from the capital markets to meet day-to-day working capital requirements such as payroll and utility bills. Its cost in the capital structure depends on the health of the company's balance sheet. A highly rated firm is able to borrow at extremely low rates, compared to a speculative company with tons of debt, which may have to pay high rates of interest in exchange for debt capital.

3. Hybrid Securities: They are a broad group of securities that combine the elements of the two broader groups of securities, debt and equity. They pay a predictable (fixed or floating) rate of return or dividend until a certain date, when the holder has a number of options like converting the securities into the underlying share. A hybrid security is structured differently and while the price of some securities behave more like fixed interest securities, others behave more like the underlying shares into which they convert. Unlike equity, the holder has a 'known' cash flow and unlike debt, there is an option to convert to the underlying equity. Common examples are: 1. Preference Shares (or preference stocks) : convertible and converting, 2. Convertible/Exchangeable Debentures or Bonds, 3. Debt with Attached Warrants and 4. Basket D Security.

4. **Other Forms of Capital:** Vendor financing is an example. A company can sell goods before they have to pay the bill to the vendor. The cost of such other forms of capital in the capital structure varies greatly on a case-by-case basis and often comes down to the talent and discipline of managers.

**Determinants of Capital Structure:**

1. **Trading on Equity:** If the rate of dividend on preference capital and the rate of interest on borrowed capital are lower than the general rate of company's earnings, a company should go for a judicious blend of preference shares, equity shares and debentures. It also becomes more important when expectations of shareholders are high.

2. **Degree of Control:** If the company's management policy favours retaining voting rights, a capital structure with debenture holders and loans rather than equity shares, is preferred.

3. **Flexibility of Finance Plan:** Issue of debentures and other loans, rather than equity shares, renders the capital structure flexible.

4. **Choice of Investors:** Bold and adventurous investors generally go for equity shares and loans and cautious investors prefer debentures. A company's capital structure should give enough choice to all kind of investors to invest.

5. **Capital Market Condition:** The market price of a company's shares has got an important influence on capital structure. During the depression period, the capital structure generally consists of debentures and loans, while in period of boom and inflation, the capital consists of share capital, generally equity shares.

6. **Period of Financing:** To raise finance for a short period, a company goes for loans from banks and other institutions, while for long periods, it goes for issue of shares and debentures.

7. **Cost of Financing:** At the time of profit earning debentures prove to be a cheaper source of finance compared to equity shares, as equity shareholders demand an extra share in profits.

8. **Stability of Sales:** A mature company with high sales and profits and better positioned to meet its fixed commitments, like interest on debentures and dividends on preference shares, from its internal revenues doesn't need external sources of funds. For a growing company with unstable revenues and not in a position to meet fixed obligations, equity capital source is a safer bet than going for a high debt load.

9. **Size of a Company:** The bigger the size of a company, the wider is its total capitalization. Small firms generally depend on loans from banks and retained profits, whereas big companies with goodwill, stability and an established profit, can easily go for issuance of shares and debentures as well as loans and borrowings from financial institutions.

10. **Management Style:** A conservative management is less inclined to use debt to increase profits, whereas an aggressive one may use significant amounts of debt to ramp up the growth of the company's earnings per share.

## **Important Factors Affecting the Choice of Capital Structure**

Under the capital structure decision the proportion of long-term sources of capital is determined. Most favourable proportion, wherein earnings per share (E.P.S.) happens to be the maximum, determines the optimum capital structure. Some of the chief factors affecting the choice of the capital structure are the following:

**(1) Cash Flow Position:** While making a choice of the capital structure the future cash flow position should be kept in mind. Debt capital should be used only if the cash flow position is really good, because a lot of cash is needed in order to make payment of interest and refund of principal.

**(2) Interest Coverage Ratio (I.C.R.):** With the help of this ratio an effort is made to find out how many times the earnings before interests and taxes (**E.B.I.T.**) is available to the payment of interest. The capacity of a company to use debt capital will be in direct proportion to this ratio. It is possible that, in spite of a better ICR, the cash flow position of the company may be weak. Therefore, this ratio is not an appropriate measure of the capacity of a company to pay interest. It is equally important to take into consideration the cash flow position.

**(3) Debt Service Coverage Ratio (D.S.C.R.):** This ratio removes the weakness of ICR, as it shows the cash flow position of the company, the cash payments to be made, like preference dividend, interest & debt capital repayment, and the amount of cash available. A better ratio means the better capacity of the company for debt payment and utilization of more debt in the capital structure.

**(4) Return on Investment (R.O.I.):** The greater the ROI, greater is the company's capacity to utilize more debt capital.

**(5) Cost of Debt:** The capacity of a company to take debt depends on the cost of debt. If the rate of interest on the debt capital is less, more debt capital can be utilized and vice versa.

**(6) Tax Rate:** The rate of tax affects the cost of debt. If it is high, the cost of debt decreases, as the deduction of interest on the debt capital from the profits by considering it a part of expenses effects a saving in taxes.

**(7) Equity Capital:** The cost of equity capital, which means the expectations of the equity shareholders from the company, affects the use of debt capital. The greater use of debt capital increases the cost of equity capital and the risk of the equity shareholders. This limits the use of the debt capital and if debt capital is used beyond this limit, the cost of equity capital increases rapidly adversely affecting the market value of the shares, which is not a good situation.

**(8) Floatation Costs:** These are the expenses incurred while issuing securities, like equity shares, preference shares and debentures and include commission of underwriters, brokerage and stationery expenses. The lesser cost of issuing debt capital than the share capital attracts companies towards debt capital.

**(9) Risk Consideration:** There are two types of risks in business: A.) Operating/Business Risk, which is the risk of inability to discharge permanent operating costs, like rent of the building, payment of salary and insurance installment, and B.) Financial

Risk, which is the risk of inability to pay fixed financial payments, like payment of interest, preference dividend and return of the debt capital as promised by the company. The total risk depends on both types of risk. If the operating risk is less, the financial risk can be faced and more debt capital can be utilized. On the contrary, if the operating risk is high, the financial risk from the greater use of debt capital is better avoided.

**(10) Flexibility:** Capital structure should be fairly flexible, i.e. amount of capital in the business could be increased or decreased easily as per needs. If at any given time a company has more capital than necessary, then both the debt capital or preference share capital can be repaid. But repayment of equity share capital is not possible during the company's lifetime. Thus, for flexibility, issue of debt capital and preference share capital is better.

**(11) Control:** At the time of preparing capital structure the control of the existing shareholders over the affairs of the company should not be adversely affected by raising funds from issue of equity shares. When funds are raised through debt capital, there is no such effect on control, because the debenture holders have no say over the affairs of the company.

**(12) Regulatory Framework:** Capital structure is also influenced by government regulations. For instance, banking companies can raise funds by issuing share capital alone, not any other kind of security. Similarly, it is compulsory for other companies to maintain a given debt-equity ratio while raising funds. Different ideal debt-equity ratios such as 2:1; 4:1; 6:1 have been determined for different industries. The public issue of shares and debentures has to be made under the Securities Exchange Board of India (SEBI) guidelines.

**(13) Stock Market Conditions:** Stock market conditions, like upward or downward trends in capital market, can influence the selection of sources of finance. When the market is dull, investors are mostly afraid of investing in the share capital due to high risk. When conditions in the capital market are cheerful, they treat investment in the share capital as the best choice to reap profits. Companies should, therefore, make selection of capital sources as per the conditions in the capital market.

**(14) Capital Structure of Other Companies:** Capital structure is influenced by the industry to which a company is related, as all companies in a given industry have a similar pattern of capital structure. Hence there are different D/E ratios prevalent in different industries. Hence, at the time of raising funds a company must take into consideration D/E ratio prevalent in the related industry.

## 2. THEORIES OF CAPITAL STRUCTURE

### Capital Structure for a Perfect World:

There are theories to enable understanding of capital costs and designing of an appropriate capital structure of a firm. There are assumptions and definitions, which underlie those theories.

#### A) Assumptions:

- Firms employ only two types of capital: debt and equity.

- The total assets of the firm are given. The degree of average can be changed by selling debt to purchase shares or selling shares to retire debt.
- The firm has a policy of paying 100 per cent dividends.
- The operating earnings of the firm are not expected to grow.
- The business risk is assumed to be constant & independent of capital structure and financial risk. Firms can be grouped into homogeneous risk classes.
- The corporate income taxes do not exist (this assumption was relaxed later on).

## B) Basic Definitions:

**Table 1: Technical Terms & their Formulae**

Terms	Formula
<b>Cost of debt (Kd)</b>	<b>R/D</b>
<b>Value of debt (d)</b>	<b>R/Kd</b>
<b>Equity (Ke)</b>	<b>(D/P) + g</b>
<b>P Value of equity (S)</b>	<b>(<math>\bar{x}</math> - Kd.D) / Ke</b>
<b>Weighted average cost of capital (Ko)</b>	<b><math>\bar{x} / V = \text{NOI} / V</math></b>
<b>Total value of the firm (V)</b>	<b>(S + D) = <math>\bar{x} / \text{Ko} = \text{NOI} / \text{Ko}</math></b>

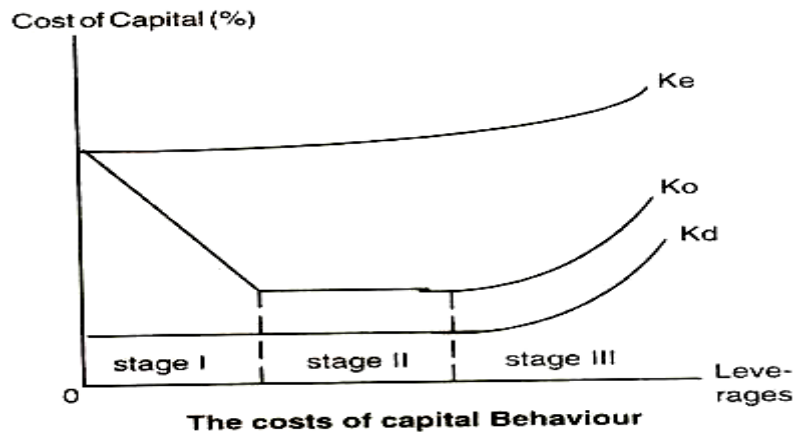
[Where S = Market value of common shares; D = Market value of debt; V = Total market value of the firm (S + D); NOI =  $\bar{x}$  = Expected net operation income, i.e. EBIT; R = Interest charges (Kd.D); NI =  $\bar{x}$  = Net income or shareholders' earnings; g = Growth rate; p = Market price per share] *Source: Financial Management by Smriti Chand*

## C) Important Theories:

**David Durand Views:** This identifies 2 extreme approaches instead of an optimum position on capital structure. As per the Net Income Approach, the cost of debt and cost of equity are assumed to be independent of the capital structure and the weighted average cost of capital declines and the total value of the firm rises with increased use of average, which is a significant variable. So financing decisions have an important effect on the value of the firm. Under the Net Operating Income approach, the cost of equity is assumed to increase linearly with average and as a result, the weighted average cost of capital remains constant and the total value of the firm also remains constant as average changes. As per this approach, the financing decision should not be of great concern to the financial manager, as it does not matter in the valuation of the firm.

**Traditional View:** As per this view, which is a compromise between the 2 approaches of David Durand, the value of a firm can be increased or the cost of capital can be reduced by the judicious mix of debt and equity capital. It clearly implies that the cost of capital decreases within the reasonable limits of debt (leverage) and then increases. An optimum capital structure occurs when the cost of capital is minimum or the value of the firm is maximum. The manner in which the overall cost of capital reacts to changes in capital structure can be divided into three stages.

**Figure1: Relationship between cost of capital & changes in capital structure**



Source: Financial Management by Smriti Chand

The traditional view is criticized, as 1. it implies that totality of risk incurred by all security-holders of a firm can be altered by changing the way in which this totality of risk is distributed among the various classes of securities and 2. the assumption that the cost of equity remains unaffected by leverage up to some reasonable limit (as per Modigliani & Millar)

### Modigliani and Miller (M.M.) Hypothesis

It forms the basis for modern thinking on capital structure, though generally viewed as purely theoretical due to its disregard for many determinants of capital structure, like fluctuations and uncertainties in the course of financing a firm, and other reasons, like bankruptcy costs, agency costs, taxes, and information asymmetry. It provides the base with which to examine real world reasons for capital structure becoming relevant. This analysis can then be extended to look at whether there is in fact an optimal capital structure: the one which maximizes the value of the firm. It is identical to the NOI approach. It can be explained in terms of 2 propositions, which are subject to the stated assumptions and perfect market conditions.

Proposition-I: For firms in the same risk class, the total market value is independent of the debt equity combination and is given by capitalizing the expected net operating income by the rate appropriate to that risk class. The average cost of capital is a constant and is not affected by leverage. If two identical firms, except for the degree of leverage, have different market values or the costs of capital, arbitrary process will take place to enable investors engage in 'personal leverage' as against the 'corporate leverage' to restore equilibrium in the market. This proposition can be expressed as:

$$V = (S + D) = \frac{\bar{x}}{K_o} = \frac{NOI}{K_o}$$

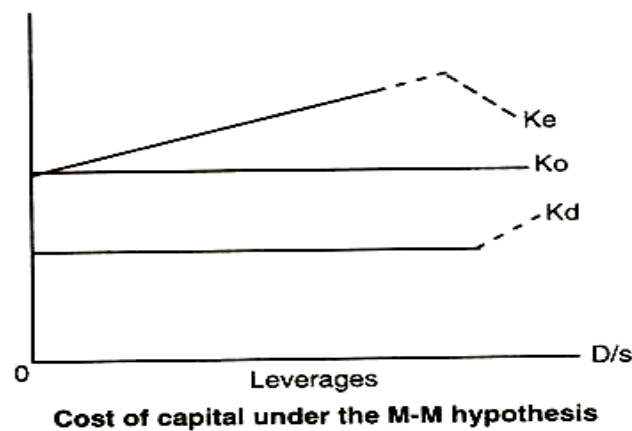
Proposition-II: It defines the cost of equity, follows from their proposition and derives a formula.

$$K_e = K_o + (K_o - K_d) D/S$$



The above equation states that, for any firm in a given risk class, the cost of equity ( $K_e$ ) is equal to the constant average cost of capital ( $K_o$ ) plus a premium for the financial risk, which is equal to debt-equity ratio times the spread between the constant average of 'capital' and the cost of debt,  $(K_o - K_d) D/S$ . The crucial part is that  $K_e$  will not rise even if very excessive raise of leverage is made. This conclusion could be valid if the cost of borrowings ( $K_d$ ) remains constant for any degree of leverage. But in practice  $K_d$  increases with leverage beyond a certain reasonable level of debt. As per the theory, even if the cost of debt,  $K_d$ , is increasing, the weighted average cost of capital,  $K_o$ , will remain constant and  $K_e$  will increase at a decreasing rate and may even turn down eventually, as illustrated in the figure.

**Figure 2: Cost of Capital Behaviour under M-M Hypothesis**



Source: Financial Management by Smriti Chand

The shortcoming of the M-M hypothesis lies in the assumption of a perfect capital market in which arbitrage is expected to work. Due to the imperfections in the real capital market, arbitrage will fail to work and will give rise to discrepancy between the market values of levered and unlevered firms. The analysis was later extended to include the effect of taxes and risky debt.

### Capital Structure for Real World:

If capital structure is irrelevant in a perfect market, then imperfections which exist in the real world must be the cause of its relevance. The following theories try to address some of these imperfections, by relaxing assumptions made in the M&M model.

A) Trade-off Theory: It factors the cost of bankruptcy and states that financing with debt has an advantage (tax benefit) and a cost (bankruptcy and financial distress). The marginal benefit of further increases in debt declines as debt increases, while the marginal cost increases, so that a firm that is optimizing its overall value should focus on this trade-off, when choosing how much debt and equity to use for financing. This theory explains differences in debt-equity (D/E) ratios between industries, but it doesn't explain differences within the same industry.

B) Pecking Order Theory: It factors the costs of asymmetric information and states that companies prioritize their sources of financing according to the law of least effort or least resistance. Businesses adhere to a hierarchy of financing sources, wherein internal financing is used first; when that is depleted, then debt is issued; and when it is no longer sensible to issue any more debt, equity is issued (as last resort). The pecking order theory has been popularized by Myers (1984).

C) Agency Costs: There are three types of agency costs, which explain the relevance of capital structure.

Asset substitution effect: As D/E increases, management has an increased incentive to undertake risky, even negative net present value (**N.P.V.**) projects. NPV is a financial technique, which uses a project's costs and returns over time to determine, if the project will make a positive return. This is because if the project is successful, share holders get all the upside, whereas if it is unsuccessful, debt holders get all the downside.

Underinvestment problem (or debt overhang problem): If debt is risky, as in a growth company, the gain from the project will accrue to debt holders, rather than to shareholders. Thus managements have an incentive to reject positive NPV projects, even though they have the potential to increase firm value.

Free cash flow: Unless free cash flow is given back to investors, management has an incentive to destroy firm value through empire building and perks. Increasing leverage imposes financial discipline on management.

### **Capital structure practices in India**

The research studies conducted in India on the choice of capital structure have revealed that:

- The cost of capital being affected by debt and equity mix, as per the traditional view, holds good and has been brought out by the studies on the consumer goods industry and the intermediate goods firms.
- Though the earlier studies in 1984 have revealed the general preference of corporate managers for debt over equity, more recent studies of 1998 have shown that Indian corporate firms are showing an almost equal preference for debt and equity in the design of their capital structure, because of uncertain returns on investment due to increasing competition as well as easiness in raising money and investor goodwill by payment of dividends in case of equity funds, despite debt being a cheaper source of finance with tax advantages.
- A 1975 study has shown a significant relationship between share value of a company and variables, like return on investment, risk, growth size and leverage.

## **3. METHODOLOGY**

The present study is more of a conceptual than an empirical study aiming at detailed analysis of the capital structure decisions of a corporate entity. The source of data are secondary data from a company's annual reports. The data are proposed to be analyzed for bringing out any relationship between the capital structure and the financial performance. From a study of such a relationship inferences are to be drawn and overall conclusions are to

be arrived at towards optimizing capital structure decisions for better financial performance and health of companies. Though the study involves generalization from a single case study, it is supposed to be an academic exercise within the resource constraints towards elucidation of a complex corporate finance problem. It is hoped that the present study, despite the limitations, shall stimulates more extensive future studies to elucidate the complex relationships between capital structure decisions and the financial performances of companies.

#### 4. CASE STUDY: DR. REDDY'S LABORATORIES



Source: Dr. Reddy's Lab. Website

##### 4.1 Introduction

Dr. Reddy's Laboratories Limited (Dr. Reddy's or DRL) is an integrated global pharmaceutical company committed to providing affordable and innovative medicines through three core business segments: Global Generics (GG), Pharmaceutical Services and Active Ingredients (PSAI) and Proprietary Products.

##### 4.2 Key Financial highlights, FY2015

<b>Revenue Rs. 148.19 bn ↑12% (US\$ 2.38 bn)</b>
<b>Gross Profit Margin: 57.6% (2015) vs 57.4% (2014)</b>
<b>Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) Rs. 36.17 bn ↑9%: 24% of revenue (US\$ 580 mn)</b>
<b>Profit Before Tax (PBT): Rs. 28.16 bn ↑6% 19% of revenue (US\$ 452 mn)</b>
<b>Profits After Tax (PAT): Rs. 22.18 bn ↑3% 15% of revenue (US\$ 356 mn)</b>
<b>Cash and Cash Equivalents (including other investments): Rs. 39.65 bn ↑18% (US\$ 636 mn)</b>

All US dollar amounts based on the convenience translation rate of US\$ 1 = ₹ 62.31

### 4.3 Consolidated financials

The abridged IFRS consolidated financial performance of Dr. Reddy's for FY2015 compared to FY2014 is as follows:

**Revenues:** Revenues increased by 12% to Rs. 148,189 million in FY2015. Revenue growth was largely driven by Global Generics segment's operations in North America, Venezuela and India. Adverse exchange rates movement resulted in lower reported revenues, because of the decrease in Indian rupee realization from sales in euro and Russian rouble.

**Gross Profit:** Gross profit rose by 13% to Rs. 85,403 million in FY2015. This translates to a gross profit margin of 57.6% in FY2015 versus 57.4% in FY2014. The gross profit margin for G.G. was 65.2%; and for the PSAI business, 22.4%. After taking into account the impact of the exchange rate fluctuations of the Indian rupee against multiple currencies in the markets in which the Company operates, gross profits from the Global Generics segment decreased due to impact of changes in the existing business mix (i.e., a fall in the share of sales of higher gross margin products and an increase in the share of relatively lower gross margin products). Factors that positively affected gross profit margins for the PSAI segment include an increase in sales of products with higher gross profit margins during the year.

**Selling, General And Administrative Expenses (SG&A):** SG&A expenses including amortization that increased by 10% to Rs. 42,585 million in FY2015 was primarily due to manpower expenses, sales and marketing costs and the impact of exchange rate fluctuations of the Indian rupee against multiple currencies in the markets of operation. SG&A accounted for 28.7% of sales in FY2015, which was 60 basis points lower than the previous year.

**R&D Expenses:** R&D expenses increased by 41% to Rs. 17,449 million in FY2015 and accounted for 11.8% of sales, against 9.4% in FY2014. This growth is in line with the Company's efforts to focus on the development of a specialized pipeline consisting of niche and differentiated products.

**Net Finance Income:** Net finance income was Rs. 1,682 million in FY2015 against Rs. 400 million in FY2014.

**Income Tax:** For FY2015, income tax expense was Rs. 5,984 million, with an effective tax rate of 21.2% against Rs. 5,094 million in FY2014 with an effective tax rate of 19.1%.

**Net Profit:** Net profit increased by 3% to Rs. 22,179 million in FY2015. This represents a profit after tax (PAT) margin of 15% of revenues against 16.3% in FY2014.

**Liquidity And Capital Resources:** Cash generated from operating activities in FY2015 was Rs. 25,033 million. Investing activities amounting to Rs. 22,904 million includes net investment in property, plant, equipment and intangibles to build capacity and capabilities for future business growth. Cash outflow from financing activities was Rs. 4,118 million.

**Debt-Equity:** In FY2015, long term borrowings (the current plus non-current portion) decreased by Rs. 2,866 million. Short-term borrowing rose by Rs. 1,250 million. As on 31 March 2015, the Company's debt to equity position was at 0.39 compared to 0.49 last year. The net debt to equity position was at 0.03 versus 0.12 last year.

**Enterprise-wide Risk Management (ERM):** Objectives of Dr. Reddy's ERM function:

- Proactively identify and highlight risks to the right stakeholders
- Facilitate discussions around risk prioritization and mitigation
- Provide a framework to assess risk capacity and appetite; develop systems to warn when the appetite is getting breached
- Provide an analysis of residual risk

The Company's business units and functions are the primary source for risk identification. The ERM team also regularly monitors external trends on liabilities as well as risks reported by peers.

**Risk Identification and Mitigation at the Business Unit or Function Level:** The ERM team focuses on identification of key business, operational and strategic risks, through structured interviews, surveys, on-call discussions or incidents. The ERM team collaborates with the Compliance, SOX (Sarbanes Oxley Act, 2002) and Internal Audit teams on compliance, financial reporting and process aspects for identifying and mitigating risks. Mitigation is periodically reviewed and the progress on key risks are discussed at the Company's management-level and Board-level Risk Committees.

**Risk Aggregation, Prioritization And Mitigation at the Organizational Level:** Risks are aggregated at the unit/function and organization level and categorized by risk groups into (i) Preventable, (ii) Strategic and (iii) External risks. The Finance, Investment and Risk Management Council (or FIRM Council) is the Company's management committee that helps the ERM function to prioritize organization-wide risks, review and steer mitigation efforts in line with the Company's risk capacity and appetite. It also oversees financial risk management and capital allocation decisions.

**Reviewing the Status of Mitigation and Residual Risks:** The Head of ERM team provides periodic updates to the FIRM Council and the Risk Committee of the Board of Directors, like (i) quarterly updates on the progress of mitigation of key risks, and (ii) specific initiatives carried out on risks during the year. During FY2015, the ERM team facilitated mitigation for certain geo-political and country risks, on forex and devaluation of currencies, on transfer risk and on people security. The team enhanced its key risk indicator tracking capabilities, developed a loss-data tracker and constructed a key learning's summary for the year. On financial risk management, the team helped in developing a framework to enable making capital allocation decisions. It also assisted management in documentation and review of internal financial controls, as required by the Companies Act, 2013.

**Outlook:** The Company is focused on profitable growth and a leadership position in GG and PSAI for a significant value in the near term. In GG, through portfolio expansion, cost leadership, consistent delivery of limited competition products and supply chain excellence and in PSAI, through creating compelling value information. In Proprietary Products, the aim is to create a viable business by calibrating investments to produce a self-sustainable model. In a dynamic environment, Dr. Reddy's base business model is exposed to volatility, both upwards and downwards. While the upsides create non-linear value for the organization, there is a conscious attempt to protect it against the downsides.

## Five year at a glance

**Table 2: Income Statement over 5 years**

	(Rs. in million)				
<b>Year Ending March 31 Income Statement Data</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Revenues	148,189	132,170	116,266	96,737	74,693
Cost of revenues	62,786	56,369	55,687	43,432	34,430
<b>Gross profit</b>	<b>85,403</b>	<b>75,801</b>	<b>60,579</b>	<b>53,305</b>	<b>40,263</b>
as a % of revenues	57.6	57.4	52.1	55.1	53.9
<b>Operating Expenses</b>					
Selling, general and administrative expenses*	42,585	38,783	34,272	29,907	23,689
Research and development expenses	17,449	12,402	7,674	5,911	5,060
Other Operating (income)/expenses, net	(917)	(1,416)	(2,479)	(765)	(1,115)
<b>Total operating expenses</b>	<b>59,117</b>	<b>49,769</b>	<b>39,467</b>	<b>35,053</b>	<b>27,634</b>
<b>Operating income</b>	<b>26,286</b>	<b>26,032</b>	<b>21,112</b>	<b>18,252</b>	<b>12,629</b>
as a % of revenues	18	20	18	19	17
<b>FINANCE COSTS, NET</b>					
Finance income	2,774	1,674	1,478	1,227	173
Finance expenses	(1,092)	(1,274)	(1,018)	(1,067)	(362)
<b>Finance (expense)/income, net</b>	<b>1,682</b>	<b>400</b>	<b>460</b>	<b>160</b>	<b>(189)</b>
Share of profit of equity accounted investees, net of income tax	195	174	104	54	3
<b>Profit before income tax</b>	<b>28,163</b>	<b>26,606</b>	<b>21,676</b>	<b>18,466</b>	<b>12,443</b>
Income tax benefit/(expense)	(5,984)	(5,094)	(4,900)	(4,204)	(1,403)
<b>Profit for the year</b>	<b>22,179</b>	<b>21,512</b>	<b>16,776</b>	<b>14,262</b>	<b>11,040</b>
as a % of revenues	15	16	14	15	15
<b>Earnings per Share</b>					
– Basic	130.2	126.5	98.8	84.2	65.3
– Diluted	129.7	126.0	98.4	83.8	65.0
Dividend declared per share (Rs.)	20.0	18.0	15.0	13.8	11.3
<b>Balance Sheet Data</b>					
Cash and cash equivalents; net of bank overdraft	5,394	8,451	5,054	7,379	5,660
Operating working capital**	55,624	46,526	41,710	35,189	25,194
Total assets	194,762	170,223	142,369	119,477	95,005
Total long-term debt excluding current portion	14,307	20,740	12,625	16,335	5,271
Total stockholders' equity	111,302	90,801	72,805	57,287	45,803
<b>Additional Data</b>					
Net Cash Provided By/(Used In)					
Operating activities	25,033	19,463	13,317	16,150	8,009
Investing activities	(22,904)	(16,620)	(13,944)	(18,665)	(8,658)
Financing activities	(4,118)	(217)	(1,792)	3,735	(377)

Effect of exchange rate changes on cash	(1,068)	771	94	499	141
Expenditure on property, plant and equipment & Intangibles	(15,327)	(10,627)	(7,336)	(8,585)	(11,606)

Notes: \*Includes impairment of goodwill and other intangibles and reversal of impairment.

Figures are regrouped for previous years

\*\* Operating working capital = Trade receivables + Inventories - Trade payables

All figures are based on IFRS consolidated financial statements

## Key financial ratio

**Table 3: Financial Performance over 5 Years**

Year Ending March 31	2015	2014	2013	2012	2011
<b>Profitability Ratios</b>					
EBITDA margin %	24%	25%	24%	26%	22%
Gross Margin %	58%	57%	52%	55%	54%
– Global Generics	65%	66%	59%	63%	65%
– PSAI	22%	20%	32%	32%	26%
Adjusted PAT* margin %	15%	16%	15%	16%	14%
<b>Asset Productivity Ratios</b>					
Fixed Asset Turnover	3.2	3.2	3.3	3.1	2.9
Total Assets Turnover	0.8	0.8	0.9	0.9	0.9
<b>Working Capital Ratios</b>					
Working Capital Days	173	165	154	154	134
Inventory Days	144	148	134	149	156
Debtors Days	91	90	90	81	72
Creditor Days	62	72	70	76	94
<b>Gearing Ratios</b>					
Net Debt/Equity	0.03	0.12	0.20	0.24	0.39
<b>Valuation Ratios</b>					
Earnings per share (Rs.)	129.7	126.0	98.4	83.8	65.0
Book Value per share (Rs.)	651	532	427	337	269
Dividend Payout (%)	15.4%	14%	15%	16%	17%
Trailing Price/Earnings Ratio	26.9	20.3	17.9	19.6	28.7

Notes: (1) Fixed Asset Turnover: Net Sales/Avg Net Fixed Assets (Property, plant and equipment)

(2) Total Asset Turnover: Net Sales/Avg Total Assets

(3) Working Capital Days: Inventory Days + Receivable Days – Payable Days

(4) Inventory Days: Average Inventory/Cost of Revenue\* 365

(5) Receivable Day: Average Trade Receivables/Turnover\* 365

(6) Payable Days: Average Trade Payables/Cost of Revenue\* 365

(7) Book Value per share: Equity/Outstanding equity shares (diluted)

(8) Dividend Payout: DPS/EPS (9) Trailing price: Closing share price on the last working day of March

\* PAT (Profit After Tax) adjusted for major non-cash impairment charge and other non-recurring costs

Source: All figures in Tables 2 & 3 are based on IFRS consolidated financial statements of Dr. Reddy's Labs..

### **Capital structure and Financial performance**

#### **Key Financial Performance Indicators of Dr. Reddy's Labs. from 2011 to 2015:**

- Revenues grew by 12.1% y-o-y primarily on account of DRL's Global Generics segment's operations in the North America, India and "Rest of the World" markets, primarily Venezuela. A 5-year 'Compounded Annual Growth Rate' (CAGR) of 19% was achieved.
- Gross Profit (as a percentage to sales) improved primarily due to an increase in sales of products with higher gross profit margins during the year.
- EBITDA increased by 9% (a 5-year CAGR) to Rs. 36,168 million or 24.4% of revenues.
- Profit Before Tax (PBT) grew by 6% y-o-y. or by a 5-year CAGR of 11%.
- Earnings per share also has shown a significant rise over the 5 years.
- Dr. Reddy's has a good dividend paying track record and has consistently declared dividends for the last 15 years. Though the average dividend yield is not quite high compared to the prevailing yields of the pharmaceutical industry, investors still value its shares because of increasing market price of its shares.

### **Capital Structure Decisions & Impact on Financial Performance**

- The company's initial financial growth was more from borrowers' money, as their assets and equity were not sufficient to fund the total liabilities.
- This situation of over-dependence on debt was not safe in the long run, because of the risks of financial distress and bankruptcy.
- The company has increased its share capital through various policy decisions, like Dr. Reddy's Employees Stock Option Plan.
- The company has also paid out its long-term borrowings, as its market position got strengthened.
- Lesser dependence on debt has been brought out by the company's decreasing debt-equity and debt-asset ratios.
- 

Dr. Reddy's is an established, mature global pharmaceutical company. Its capital structure decisions is in keeping with the established financial wisdom of less dependence on debt than on equity to safeguard the financial health in long-term from risks of distress and bankruptcy, while improving liquidity, solvency and market leadership. Its good financial performance in the highly competitive and dynamic pharmaceutical industry over the last 5 years has been consistent with its capital structure decisions, as brought out by the annual financial reports.

## **5. CONCLUSION**

The present study strengthens the conventional wisdom of appropriate capital structure decisions, which are consistent with the industry and the financial and maturity status of a business entity in the industry. The present case study has involved the financial performance of a mature pharmaceutical company and the relevance of its capital structure



decisions to its business environment. There are no fit-for-all rules in terms of capital structure for all business entities. The capital structure decisions should be appropriate to the determinants in the business environment and the financial base and the development stage of an entity. A well thought-out capital structure is one of the determinants of successful financial performance, but other factors, like improving productivity and seeking out higher return products also count.

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# **MORAL MANAGER AND CORPORATE SUSTAINABILITY**

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## **ABSTRACT**

The central thesis of this conceptual paper is that moral manager is a driver of corporate sustainability. The moral manager possesses moral value and virtue that support corporate sustainability. The key moral value of altruism is a guiding principle for the moral manager to think of others first. The four cardinal virtues, consisting of prudence (or wisdom), fortitude (or courage), temperance, and justice, of the moral manager, are practiced at all times by the moral manager who has great concern for others while being aware of his/her deficiencies. The value of altruism and the cardinal virtues of the moral manager can support corporate sustainability, which is mainly involved with the stakeholders of the corporate situated in the society. These stakeholders are “the others” that the manager would respond to their short-term needs without compromising the ability to meet future needs. Out of his/ her concern for the others, the moral manager employs prudence or wisdom in making his/her decisions that may affect the others and he/she proceeds with fortitude or courage to act with justice or fairness for the others. The moral manager practices temperance, which is involved with controlling his/ her emotions and be aware of his/her deficiencies, in dealing with the others. In sum, the paper attempts to point out that “corporate sustainability”, and not just corporate responsibility, is grounded in morality since the moral manager who is the implementer for achieving the corporate sustainability has the attributes that support corporate sustainability.

Keywords: moral value, virtue, sustainability, altruism, prudence

# MORAL MANAGER AND CORPORATE SUSTAINABILITY

## 1. INTRODUCTION

Corporate sustainability, which is generally described as the balance of resources for present or future stakeholders, is one subject that has received growing interest from both academicians and practitioners in the last few decades. This may be due to the growing recognition of prevalent depletion of resources, vast deteriorating environments, and a trend to shift corporate focus from short-term benefits to long-term sustenance.

To address the issue of corporate sustainability, organizations have commonly employed the approach of Corporate Social Responsibility (CSR). Many organizations seem to believe that by showing their responsibility to societies and to environments, stakeholders of their organizations should prolong their sustenance in business. In other words, they seem to believe that responsibility can assure sustainability of their organizations. Some academicians (e.g., Metcalf & Benn, 2013) also held similar views and treat corporate responsibility as interchangeable with corporate sustainability. However, there is also a contrasting idea to this belief. For example, Bansal and Des Jardine (2015) indicate that many supposedly responsible firms borrow resources and capital from the future at the risk of long-term survival and in this regard, the firms are responsible but are not sustainable. In connection with this idea, Bansal and Des Jardine (2015) ground corporate social responsibility in ethics, morality and norms but indicate that the only moral imperative that grounds sustainability is the need to balance the short- and long- term supply and demand of resources.

The role of the balancer of resources typically pertains to managers or leaders. Previous studies have called for leaders with superior abilities to handle corporate sustainability. For example, Metcalf and Benn (2013) have called for leaders who can read and predict through complexity, think through complex problems, engage groups in dynamic adaptive organizational change and have the emotional intelligence to adaptively engage with their own emotions associated with complex problem solving. Few previous empirical studies have also found that specific types of individual or leaders' values are related to sustainability aspects such as propensity for sustainability actions or sustainability strategies.

Although corporate sustainability has received growing interest, the study on the attributes of human resource that can lead to sustainability has been scant. This study thus focuses on the attributes of managers/ leaders that can support corporate sustainability. The virtue theory framework has been brought in to coincide with the notion of "value" to prescribe the attributes of managers or leaders who can be a driver of corporate sustainability. My proposition is that corporate sustainability is not driven mainly by the moral imperative to balance resources over time (as suggested by Bansal & Des Jardine, 2015); rather corporate sustainability is driven mainly by managers' value and virtue with regard to others. Only when managers hold the value of altruism which guides their virtues with concern for others first, they will then attempt to balance resources in such a way to keep resources for the future others. On the contrary, managers who are not altruistic will think of themselves first and tend to maximize the use of resources in the short-term and this will jeopardize long-term sustenance of organizations.

Based on this proposition, the study will first describe the concept of moral manager and corporate sustainability. Then the relation between moral manager and corporate sustainability will be addressed and the discussion be raised. The concepts of the study should contribute to the academic and practical field. The concepts prescribe managers' moral value and moral virtue necessary for corporate sustainability with the rationale behind. The propositions are also made to provide a basis for further empirical analysis.

## **2. LITERATURE REVIEW**

### **Moral Manager**

A moral manager is conceptualized in this study as a manager who possesses moral value and virtues. Based on literature review, virtue is understood as a moral practice that deals with a balance between two extremes whereas moral value is a guiding principle or motivation for such practice.

### **Moral Value of a Manager**

One of the most cited definitions of "value" was proposed by Rokeach (1973) as: "an enduring belief that a specific mode of conduct or end state of existence is personally or socially preferable to an opposite or converse mode of conduct or end-state of existence" (p.5). Rokeach classified values into either terminal values (desirable end-states of existence) or instrumental values (modes of behavior or means of achieving the desirable end-states). In terms of moral value, Rokeach (1973) mentions about its interpersonal focus as: "moral values refer only to certain kinds of instrumental values, to those that have an interpersonal focus which, when violated, arouse pangs of conscience or feelings of guilt for wrongdoing". Schwartz (2006) expanded on Rokeach's theory and developed a framework for understanding the motivational aspects of values, as well as for identifying value types (cf. Kaldschmidt, 2011). According to Schwartz (2006) values are "desirable, trans-situational goals, varying in importance, that serve as guiding principles in people's lives" (p.1). This study takes the notion (Schwartz, 2006) that value acts as a guiding principle in people's lives and the notion (of Rokeach's, 1973) that moral value is an instrumental value for those having an interpersonal focus with conscience.

Scholars have suggested the relationship between values and choices as well as behaviors. With regard to choices, Fritzsche (2004) posited personal values to be a major component of an individual's personal traits that influence the ethical dimension of his/her decision behavior. Williams (1968) argues that values have cognitive, affective, and directional aspects, which when fully conceptualized become criteria for judgment, preference, and choice (Fritzsche & Oz, 2007). As for behaviors, Bardi and Schwartz (2003) find that values motivate behavior.

Few previous empirical works on value and sustainability have been available. A recent study by Marcus, MacDonald and Suisky (2015), for example, used a policy-capturing approach to examine how individuals' economic, social and environmental values influence their propensity to engage in a broad range of sustainability-related corporate actions. A policy-capturing method is a within-person idiographic regression-based technique commonly used to understand how individuals differentially weight informational cues. Economic values give pre-eminence to profit maximization and shareholder value creation as

the desired end goal. Economic values relate to financial objectives and the use of rational and quantifiable means to their attainment. On the other hand, social values are predominantly altruistic or other-oriented in nature. Individuals with strong social values are oriented towards maintaining positive social relations and improving human well-being. Environmental values relate to the desired end state of natural systems integrity and the means of human adaptation to, rather than domination over, the natural environment. Finally, balanced values are defined as the enduring belief that economic, social and environmental objectives are mutually desirable and interrelated. Financial concerns are not given ultimate precedence, but are balanced within a holistic framework of various stakeholder needs, interests and demands. They found that the stronger an individual's social or environmental values, the greater their likelihood of adopting beneficial (and avoiding harmful) social and environmental firm actions respectively. They indicate that stronger social values may be particularly valuable in helping guard against corporate actions that could compromise sustainability goals. They also found that strong economic values increased the propensity to engage in corporate actions that undermine long-term sustainability and to work in controversial industries. Individuals with balanced values were as likely as those with strong economic values to pursue positive economic outcomes, but without the same downside potential for concern actions. The limitation of the work, however, is that it was conducted with a student sample population with limited life and work experience.

Despite the limitation, the study by Marcus et al. (2015) is interesting in the sense that it classifies values into economic, social, environmental, and balanced value and compares the influence exerted by values on the propensity to engage in actions. Based on its definition of social value, which is predominantly altruistic or other-oriented in nature, this is relevant to the moral value of altruism in this study. Their finding of the relation between the social value and the likelihood of adopting social and environmental actions can provide support to the concept that altruism is related to corporate sustainability (perhaps from social and ecological sustainability aspects). In addition, their finding that individuals with balanced values were as likely as those with strong economic values to pursue positive economic outcomes, but without the same downside potential for concern actions, indicates that individuals can seek to balance different types of values and hence balance their actions of concern. In other words, the finding supports the notion that individuals can manage to balance their actions with regard to several dimensions of sustainability and this fits with what a "moral manager" is supposed to do.

Another empirical study on value and sustainability (in term of strategies) that should be mentioned here employed values theory proposed by Schwartz. Kaldschmidt (2011) investigates empirically the relationship between leaders' value and sustainability strategies. Her dissertation on the topic: "The Values of Sustainability: The Influence of Leaders' Personal Values on Sustainability Strategies" is concerned with how leaders' personal value influence the formulation and implementation of corporate sustainability strategies. The focal point is on the process of strategy development. According to Schwartz's values theory (e.g., Bardi & Schwartz, 2003), values guide individuals and are grounded in what they see as desirable. Values may vary in their importance, but remain relatively stable. Values motivate behavior, serve interests, and are standards for the evaluation of decisions, actions, events, and so on. There is a dynamic relationship between values that reflects the conflicts and congruencies between them. Schwartz defines ten basic values (self-direction, stimulation, hedonism, achievement, power, security, conformity, tradition, benevolence, and universalism) which are summarized into higher order values, based on their motivational aspects. The higher order values comprise: openness to change which reflects the pursuit of

personal intellectual and emotional inclinations without regard for the results or outcomes of the pursuit; self-enhancement which reflects a self-focus and the following of personal interests, regardless of the effects that these pursuits may have on others; conservation reflects self-restriction in favor of maintaining relationships and the status quo; and self-transcendence which concerns the achievement of personal interests through the prioritization of the promotion of others' well-being and the welfare of the natural environment (p.101). The findings from the quantitative phase, i.e., a survey of 28 German family owned small and medium sized enterprises (SMEs) who have already demonstrated their commitment to sustainability, indicate that a values profile combining self-transcendent and openness to change values characterizes the leaders of these firms and that this value profile leads to transformative, innovative, and credible corporate sustainability strategy types. In addition, the evidence from two contrasting case studies indicates that pro-socially and pro-environmentally oriented leaders promote their values and the associated strategies through active development of common and aligned values within the firm. This leads to a high consensus on strategic directions and implementation.

The empirical study by Kaldschmidt (2011) thus provide support to the relationship between values of altruistic nature as well as wisdom and corporate sustainability strategy types. Whereas the value of self-transcendence is more like the value of altruism, the value of openness to change seems consistent with the virtue of prudence since it is led by wisdom. The study by Kaldschmidt (2011), however, differs from this study in several aspects, i.e., (a) its focus is on the sustainability strategy rather than on sustainability with different dimensions, (b) it identifies the value profile on the basis of Schwartz's value theory whereas this study focuses on specific value of altruism., (c) it does not refer to the virtue theory whereas this study does bring in the notions from the virtue theory.

Another study on values and organizational sustainability that may be mentioned here is the conceptual one. Florea, Cheung and Herndon (2013) attempt to integrate scholarship on organizational sustainability, human resource practices, and values in delineating how four specific values support effective human resource practices in organizations. They claim that the four values that they propose (altruism, empathy, positive norm of reciprocity, and private self-effacement) are compatible with self-enhancement and self-transcendence values, which are contrasting values as identified by Shwartz (1992). The authors suggest that self-enhancement and self-transcendence values are important drivers for the adoption and effective implementation of high-performance human resource practices that lead to organizational sustainability across cultures. Specifically, they postulate that altruism, empathy, positive norm of reciprocity, and private self-effacement will lead to the emergence and development of high-performance human resource practices. They believe that these values support organizational sustainability in all its aspects: economic prosperity (through the positive norm of reciprocity), and environmental integrity and social sustainability (through altruism, empathy, and private self-effacement). While this conceptual work of Florea et al. (2013) provides yet another linkage between (four) values and organizational sustainability, its theoretical background for the proposed values could be improved. Florea et al. (2013) refer to Schwartz (1992)'s value dichotomy which contrasts self-enhancement and self-transcendence and attempt to classify their four values under this dichotomy with no linkage to basic values proposed by Schwartz. In addition, their propositions of relating specific values to different types of sustainability may be difficult to interpret the meanings since the values are overlapping and sustainability types are also interrelated.

In sum, the three previous studies on value and sustainability being mentioned focus only on values which guide actions but did not take the virtue framework into account and this marks their difference from this current study. By bringing in the virtue theoretical framework, it builds more solid ground for explaining the actions of moral persons.

### **Moral Virtues of a Manager**

The term “virtue” refers to singular attributes that represent moral excellence. Aristotle (1999) equated virtue with “excellence in the human soul” and made the distinction between moral and intellectual virtues. Moral virtues are those that are concerned with the will and can be acquired through regular practice whereas intellectual virtues are acquired through learning. Scholars in later periods point out that virtue is primarily a practice. For instance, Whetstone (2003) refers to MacIntyre (1985) who views that a virtue is primarily, but not solely, a practice. It is a universal ideal, but is somehow fitted and combined with others in a functioning community.

Among the virtues, those that are fundamental in the sense that all other virtues are closely tied with them are the cardinal (from the Latin "cardo" which means hinge) virtues: prudence or practical wisdom, courage or fortitude, self-mastery or temperance, and justice or fairness. Virtues that have been proposed to adhere to ethical leaders are four cardinal virtues of prudence, temperance, fortitude, and justice (Riggio et al., 2010). These virtues are discussed in the ancient texts of Aristotle and St. Thomas Aquinas. Aquinas (2005: p.162), for example, considered that temperance, fortitude, and justice are moral virtues and they “concern the mean between doing too much and too little” in a given situation.

Virtue and value are viewed differently but are closely related. That is, virtue is seen as a practice to pursue primary values. “A virtue is thus viewed not as a primary value, but as a settled moral disposition towards ends a person ought to pursue, i.e., toward one’s primary values” (Holmes, 1991: p. 64). Moreover, a virtue ethical framework for organization has been proposed by using value as a link. For instance, Crossan, Mazutis, and Seijts (2013) present a comprehensive model that integrates virtues, values, character strengths and ethical decision making (EDM). They suggest that reintroducing a virtue ethical perspective to existing ethical decision making theories can help to illustrate deficiencies in existing decision-making models and suggest that character strengths and motivational values can serve as natural bridge that link a virtue framework to EDM in organizations.

The study by Arjoon (2000) attempts to develop a meta-theory of business based on virtue theory. Virtue theory holds the view that the foundation of morality lies in the development of good character traits as virtues. Arjoon (2000) links the concept of virtues, the common good, and the dynamic economy into a unifying and comprehensive theory of business. The author refers to MacIntyre (1984) who distinguished between internal and external goods or goals. Internal goals are unique, intangible, unlimited in supply, and have intrinsic value. Internal goals require an ability to recognize and to exercise virtues. External goals, on the other hand, when achieved are always some individual's property. Examples of internal goals are essentially the cardinal virtues: prudence, courage, self-mastery, and justice and examples of external goals are profits, honor, fame, prestige, and material wealth. Within a virtue theory framework, the pursuit of internal goals are the driving force for external goals. Based on this concept of MacIntyre (1984), the author indicates that the virtue theory shows that firms which pursue ethically-driven strategies can realize a greater profit potential than those firms which currently use profit-driven strategies. In other words, a firm that is



driven by virtues can be more sustainable than a firm that is driven by only profits. Arjoon (2000: p.174) concludes that

*“virtue theory constitutes a comprehensive theory of business and a context in which strategies can be developed to attain the ultimate sustainable competitive advantage. It provides a powerful philosophical and theoretical foundation for the study of leadership. It also develops a theory of (unconstrained) profits, in the sense that if firms pursued internal goals, the profits that can be realized are greater than under the traditional neoclassical profit or wealth maximizing models”.*

The work of Arjoon (2000) provides a few interesting notions. Firstly, it indicates that profit is still important for business, although not the most important. The author makes reference to Naughton, Alford and Brady (1996) who noted that “Profits then are not the most important good, but without profits (and other instrumental goods), there can be no other goods and a workplace where people develop has little relevance as the organization would cease to exist.” Secondly, profits are seen as “apparent” or instrumental goods and not the end or goal of an organization. If profits become the end of an organization, they would prevent an organization from considering or pursuing the more excellent goods of community. Finally, the end or goal of organization is “human development within an organizational context where the good of the person is recognized to be intrinsically connected to the good of the community. (Naughton et al., 1996: p.211). This can be understood that human can be developed in their virtues and these are connected to the virtue of the community. In sum, these three points can be interpreted that economic sustainability is one important dimension of corporate sustainability and it has to prevail (not as a goal, though) in order for organizations to be sustainable in other (such as ecological and social) aspects of sustainability. Though the study tends to connect human development to the good of community, but it has not mentioned the ways to achieve this.

### **Corporate Sustainability**

Sustainable development has been defined by the World Commission on Environment and Development in 1987 as development that “meets the needs of the present without compromising the ability of future generations to meet their own needs.” (The Brundtland Report, 1987: p. 2). This definition, which is grounded in the global framework, indicates the choice of serving the needs of either the present generation or the future generations. With the application to a micro level, i.e., corporate level, the focus of sustainability is more specific since it is on corporate stakeholders. Sustainability on a corporate level has been defined: “as meeting the needs of the firms’ direct and indirect stakeholders (such as shareholders, employees, clients, pressure groups, communities, etc.) without compromising its ability to meet the needs of future stakeholders as well” (Dyllick & Hockerts, 2002: p. 131).

The concept of corporate sustainability has been shifted to a broader perspective in the last two decades. Economic sustainability alone is no sufficient condition for the overall sustainability of a corporation (Gladwin, Kennelly & Krause, 1995). Environment also is not the only concern of corporate sustainability. Elkington (1997) suggested a triple bottom line approach- social sustainability, environmental sustainability and economic sustainability. The approach advocates that the long term success of a corporation and its environment requires an emphasis on all three dimensions of sustainability - economic, environmental (natural environment), and social (social environment), rather than a single, short term, emphasis on

economic sustainability. The three dimensions of sustainability are interrelated and impact each other by varied and numerous means.

Corporate sustainability has been identified with three key elements (Dyllick & Hockerts, 2002): (1) Integrating the economic, ecological and social aspects in a ‘triple-bottom line’ concept (Elkington, 1997). A single-minded focus on economic sustainability can succeed in the short run but in the long run sustainability requires all three dimensions to be satisfied simultaneously; (2) Integrating the short-term and long-term aspects. The existence of an economic discount rate tends to value short-term gains higher than distant costs caused by social or environmental degradation; and (3) Consuming the income and not the capital. In order to achieve long-term sustainability, businesses will have to manage not only economic capital, but also their natural capital and their social capital. Looking at corporate sustainability from these elements, it can be said that a manager is subject to a complex nature of sustainability. The manager is expected to manage capital (economic, natural, social) in a broad context (economic, ecological, social) over time (short-term vs long-term).

This study conceptualizes “corporate sustainability” from a broad view since it can reflect actual context of corporates. Rather than identifying corporate sustainability as either economic or environmental sustainability, corporate sustainability is considered from economic, environmental, and social aspects. Managers make choices that take into account all these aspects, which are also interrelated.

Corporate sustainability (CS) and corporate social responsibility (CSR) are discussed by some as near synonyms or interchangeable and by others as distinct concepts. This study, however, opines that CSR is only one instrument for CS, but is not the same as CS. The idea is consistent with the notion of Bansal and Des Jardine (2015) who indicate that many supposedly responsible firms borrow resources and capital from the future at the risk of long-term survival and in this regard, the firms are responsible but are not sustainable. Business sustainability is the ability of firms to respond their short-term needs without compromising the ability to meet future needs. By focusing on the “sustaining” part of sustainability, businesses can build long-term relationships, innovate enduring designs and invest in long-lasting infrastructure. Some other scholars also view that CSR is not CS. For example, Lo (2010) view that CSR is subsumed under CS, providing a transitional stage that a firm undergoes on its way to implementing CS.

### **Moral Manager for Corporate Sustainability**

A moral manager can be described as having moral value and virtues. The moral value and virtues that give priority “with regard to others” can provide support to corporate sustainability. This refers to the value of altruism and the four cardinal virtues.

*Altruism* involves concerns of a person towards others rather than own self. The definition of altruism is, for example, “acting primarily for the benefit of another instead of acting purely for self-interest” (Lieberman, 1991); “any behavior that benefits others regardless of the advantages such behavior could have for the benefactor” (Kanungo & Mendonca, 1996); and “where one seeks to maximize the outcomes of another without regard for one’s own outcomes” (Ballinger & Rockmann, 2010). Altruism is a prosocial attitude thought of as a predisposition to unselfishly help and focus upon others, associated with the affect of compassion, and resulting in acts of cooperation, caring, giving assistance, and other

selfless acts. (Hatfield, Turner & Spiller, 2013). Altruism is credited as providing the basis of ethical and moral codes (Lieberman, 1991). Based on the prosocial attitude of altruism and its role as a basis for moral codes, the value of altruism can well motivate the four cardinal virtues, which are concerned with virtuous actions of a manager towards others (to achieve the goal of corporate sustainability in this case).

The four **cardinal virtues** for a moral manager comprise: prudence, fortitude, temperance and justice. **Prudence**, the first cardinal virtue, is often associated with knowledge, practical wisdom, and insight. Prudence is the translation from the actual word *phronesis* that Aristotle used to describe the ability to find the balance between two extremes and make the appropriate decision that both minimizes harm and maximizes the good (Aristotle, 2005). Prudence can be equated to good judgment and right reasoning about people. Among the cardinal virtues, scholars have concurred that prudence is the central virtue. For example, Pieper (1966) reasoned that prudence is the most important since it is necessary in order to practice the other cardinal virtues. He argues that prudence is the first of the cardinal virtues since none but the prudent person can be just, brave, and temperate, and the good man is good in so far as he is prudent (Arjoon, 2000: p.163). MacIntyre (1984) also illustrates that prudence is a central (intellectual) virtue without which none of the moral virtues can be exercised.

The second cardinal virtue is **fortitude**, which is often called courage. Courage is the ability to face and to overcome difficult situations. It is the power to act even when one is afraid. Courage is also described as working with fear to do the right thing. Leaders act with courage or fortitude when they persevere in the face of adversity. Perseverance, patience, and endurance play vital roles in ensuring someone behaves courageously, but without prudence there can be no courage.

The third cardinal virtue is **temperance** or self-mastery, which is the ability to have control over one's tendencies to laziness, complacency, and reluctance to fulfill one's responsibility. It is the virtue that relates to enjoying things in moderation (Arjoon, 2000). Temperance is also described as the ability to control one's emotions. Leaders who are temperate shows a restrained (and prudent) desire of physical pleasures. Leaders who are temperate also are humble; they know their own deficiencies and accept them.

The final cardinal virtue is **justice**. Justice describes a situation where one constantly gives others what is their due so that they can fulfill their duties and exercise their rights, and at the same time, one also tries to see that others do likewise (Arjoon, 2000). According to Aristotle, there are two distinct types of justice -general justice that deals mostly with following laws (something is unjust if it is unlawful), and particular justice which deals with fairness (something is unjust if it is not fair). Aristotle concentrates on particular justice and describes an unjust action as one that is motivated by unjust gains. Thus, if leaders behave in a way that seeks to benefit themselves at the expense of others, these acts are unjust.

It is important to note that the idea of moderation is a key to these four cardinal virtues. The first virtue- prudence has moderation as a key since it is concerned with the ability to find the balance between two extremes and make the appropriate decision that both minimizes harm and maximizes the good. Prudence enables one to behave courageously in a moderate way. Temperance also has moderation as a key since it deals with the moderation of physical pleasures and of beliefs in the abilities of persons. While those who are temperate are not excessively preoccupied with themselves, they do not neglect themselves or their

appropriate needs. Finally, particular justice reflects the fairness of prudent persons who attempt to find the balance between two extremes. If these four cardinal virtues pertain to leaders or managers, prudent managers do what is just or fair for others; they are temperate by not being excessive in either physical or emotional pleasure; and they behave courageously (with prudence).

A moral manager, who is conceptualized in this study as having four cardinal virtues under the guidance of altruism, tends to act in the way that can support sustainability of corporates. An altruistic manager thinks of others and put these others (their stakeholders) before own self. When he/she has to make decisions, he is prudent (i.e., uses wisdom) in making choices for the benefit of present or future stakeholders, taking into account the justice or fairness between these two groups. In order to deal with a complex nature of sustainability, the moral manager employs fortitude or courage as well as temperance in engaging with involved groups, being aware of his/ her own deficiencies. The manager dares to be engaged in overt actions while being emotionally prepared to accept the responses from involved stakeholders. These four cardinal virtues could thus enable managers to be the drivers of corporate sustainability.

The four cardinal virtues provide a comprehensive framework for the attributes of moral managers. The superior abilities of leadership for sustainability raised by Metcalf and Benn (2013) can be put under this framework. Based on the position that organizations are complex adaptive systems operating within wider complex adaptive systems, Metcalf and Benn (2013, p.369) argue that leadership for sustainability requires leaders of extraordinary abilities: (a) leaders who can read and predict through complexity, (b) think through complex problems, (c) engage groups in dynamic adaptive organizational change and (d) have the emotional intelligence to adaptively engage with their own emotions associated with complex problem solving. The first two abilities indicated by Metcalf and Benn (2013) are consistent with the virtue of “prudence” (or “wisdom”) of leaders whereas the third ability requires “fortitude” of leaders to deal with others amid dynamic changes. Finally, the fourth ability is a combination of the virtue of “wisdom” and “temperance” of leaders. By employing the framework of cardinal virtue, it is evident that the “justice” of leaders has not been mentioned by Metcalf and Benn although it is one key attribute for leaders to deal effectively with groups. Metcalf and Benn (2013) state that leaders and leadership is a key interpreter of how sustainability of the organization ‘links’ to its wider systems in which the organization sits, and executing that link well requires unusual leaders and leadership systems. This study concurs with only the former part of their statement, that is, leaders need to have wisdom to see through the organization and its wider context. The latter part of their statement about the requirement of “unusual leaders and leadership systems”, however, seems excessive. Moral value and moral virtues of managers/ leaders are driving forces for sustainability of organizations. These attributes of managers/ leaders are not “unusual” since virtue has its roots in ancient Greek civilization, particularly in Aristotle’s *Nicomachean Ethics* (around 350 BCE), the earliest and most influential systematic account of virtue theory. The point is that there may be too few moral managers/ leaders and more of them are required to be drivers of sustainability of their organizations. These managers need not be “unusual” in terms of abilities but need to revert to the highly held moral value and cardinal virtues.

### **Propositions**

Based on the concept regarding moral manager and corporate sustainability, the propositions on their relationship which may be further tested can be indicated as:

- P1: A manager's moral value of altruism is positively related to corporate sustainability.
- P2: A moral manager's four cardinal virtues of prudence, fortitude, temperance, and justice, each is positively related to corporate sustainability.
- P3: A manager's moral value of altruism is positively related to each of four cardinal virtues (prudence, fortitude, temperance, and justice).

### 3. DISCUSSION

#### 3.1 Theoretical Framework

This study employs a theoretical framework of "value" and of "virtue" as a basis for a moral manager who is a driver of corporate sustainability. The study proposes the relation between a primary value of concern for others (altruism) and four cardinal virtues which are practices for and toward others (or corporate stakeholders in this case) as a priority. The linkage between value and virtue of a moral manager then extends to sustainability of corporates. While there have been previous studies that empirically explored and found the relationship between values and sustainability (represented by propensity to engage in economic, environmental, social actions) or sustainability strategies, but if we have to develop human resources capable of building sustainable organizations, only the development of relevant human values is inadequate. The reasons for this belief include the notion that different values may contradict as well as the notion that values only act as guiding principles. This is where the virtue theory fits in and helps to strengthen the role of value to ensure that human resources in organizations such as managers or leaders behave or act in accordance with their virtues under the guidance of values. Sustainability of organizations need (virtuous) actions, and not just only values, of managers.

#### 3.2 Development of the Value of Altruism

In order to develop the value of altruism to motivate altruistic acts of managers, the notions of Kanungo and Conger (1993) regarding internal moral codes of reciprocity and social responsibility may provide some insights into this kind of value. Kanungo and Conger (1993) referred to social psychologists who explain that the possibility of the development of a psychological need to behave altruistically are anchored in notions of internalizing (a) a reciprocity norm and (b) a social responsibility norm. Most people develop an internal moral code of reciprocity which dictates that individuals will help those who have helped them. Thus, a person helps others with the expectation that others will help him/her in return during times of need. This norm is indicated to be applied when one is interacting with one's equals or with those who possess greater resources. In contrast, when a person deals with others who are dependent and unable to reciprocate, an inner moral code of social responsibility may be evoked. This norm of social responsibility refers to one's internalized belief that helping others without regard to future personal benefit is a moral imperative.

The reciprocity and responsibility norms that form the basis of altruistic behaviors resemble the two highest stages of moral development suggested by Kohlberg (1969) (Kanungo & Conger, 1993). In the two highest stages of such moral development, individuals are guided by beliefs about meeting social obligations because of a utilitarian social contract and about moral righteousness which is beyond obligatory pressure. Based on this notion, my suggestion is that managers need to advance in their internalized moral beliefs about meeting social obligations and about moral righteousness (what is right and wrong) in order to

develop the value of altruism. In addition to moral development, literature review suggests other factors that are involved in the promotion of the value of altruism and altruistic behaviors in organizations such as individual predisposition, organizational climate, incentives, leaders' behaviors, etc. Thus, these factors should also be taken into account in the development of value of altruism.

### **3.3 Virtuous acts of Moral Managers for Corporate Sustainability**

The virtuous acts of moral managers need to account for character and context. This notion is based on the Aristote-lian ethic of virtue which is described as: (1) being personal (moral properties pertain to person), (2) focuses on the motivations of the actor and the sources of action, bringing a dynamic to ethical understanding, (3) being contextual, highlighting the importance of understanding the environment as it affects both the actor and his or her acts, and (4) complements other disciplines addressing human behavior (cf. Whetstone, 2001). Thus a moral manager has to understand the context of corporate (e.g., economic, environment, and social) as well as understands himself/herself in terms of moral disposition or moral development and in terms of deficiencies so that he/ she can act properly to pursue sustainability amid changing contexts.

### **3.4 Management of Three Dimensions of Corporate Sustainability**

In order to manage corporate sustainability, a moral manager may be engaged in several activities within the virtue theory framework. Corporate sustainability, according to Dyllick and Hockerts (2002), has three dimensions: economic, ecological and social aspects. Economically sustainable companies guarantee at any time cash flow sufficient to ensure liquidity while producing a persistent above average return to their shareholders. Ecologically sustainable companies use only natural resources that are consumed at a rate below the natural reproduction, or at a rate below the development of substitutes. They do not cause emissions that accumulate in the environment at a rate beyond the capacity of the natural system to absorb and assimilate these emissions. Finally they do not engage in activity that degrades eco-system services. Socially sustainable companies add value to the communities within which they operate by increasing the human capital of individual partners as well as furthering the societal capital of these communities. They manage social capital in such a way that stakeholders can understand its motivations and can broadly agree with the company's value system.

To deal with the three dimensions of sustainability within the virtue theory framework, a moral manager can lead his/her organization and human resources in the same direction. A moral manager may integrate sustainability concept into organizational goals, corporate strategies, employee training and/or employee evaluation systems, organizational decision support systems as well as day to day practices. A moral manager pursues internal goals (or cardinal virtues, according to Arjoon, 2000) which then lead to external goals of profits and thus can attain economic sustainability. The amount of profits should be sufficient for organizations to have liquidity and be able to grow moderately. Profits are, however, instrumental and not the end goal of a moral manager. A moral manager encourages shifts in organizational values and beliefs about sustainability. He/she uses effort to develop the value of altruism and cardinal virtues of staff as well as trains and motivates staff to act virtuously within an organizational context and toward community and society. These activities are connected to social sustainability since it is concerned with the development of good human resources for organization and society. The promotional

methods include: the development of organizational climate of mutual interdependency, trust and justice; the model of altruistic behaviors and integrity shown by managers/ leaders; the selective use of proper intrinsic or extrinsic rewards. As for ecological sustainability, a moral manager may, for example, push for the provision of ecological products and services or enhance customer satisfaction/ loyalty through sustainability initiatives.

#### **4. FUTURE STUDY**

Future studies could focus on an empirical analysis of the relation between moral values and moral virtues of managers (or leaders) with corporate sustainability. The propositions in this paper may be investigated with “sustainable” organizations from different dimensions of sustainability. Besides, it would be interesting to study the “moderation” aspect of virtues in terms of its effect on ethical decision-making of managers or leaders.

#### **5. CONCLUSION**

This paper brings in the “virtue” and “value” framework to propose that a moral manager has key attributes that could support corporate sustainability and that corporate sustainability is thus grounded in morality. Corporate sustainability has been viewed with a complex nature and a moral manager has to make decisions to ensure the balance of resources over time and has to involve with groups of people who may have diverse needs. The point is that amid this complex nature of sustainability for organizations, managers/ leaders are suggested to revert to a moral framework that focuses on the concept of giving priority “with regard to others” before themselves. A moral manager pursues internal goals (i.e. cardinal virtues) to generate reasonable profits to attain economic sustainability while pushing for the provision of ecological products and services with ecological concern to attain ecological sustainability. In order to attain social sustainability, a moral manager makes own advances in moral aspects and uses a variety of methods/ tools to develop moral value and virtues of employees and encourage them to contribute to organizations, community, and society. In sum, managers’ values and actions which prioritize “with regard to others” could lead to different and overall dimensions of corporate sustainability.

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# **DEVELOPING ORGANIZATIONS THROUGH EXPERIENTIAL BRANDING FOR SUSTAINABILITY**

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## **ABSTRACT**

Experiential Branding is a process by which brands create and drive interactions with consumers in all aspects of the brand experience to emotionally influence their preferences and to actively shape their perceptions of the brand

Experiential marketing, also called as "engagement marketing," "event marketing", "on-ground marketing", "live marketing" or "participation marketing," These areas of marketing strategy directly engages, invites and encourages consumers to participate in the evolution of a brand. Rather than looking at consumers as passive receivers of messages, engagement marketers believe that consumers should be actively involved in the production and co-creation of marketing programs, developing a relationship with the brand.

Today's consumers are confronted with countless choices and a multitude of information to consider when they buy products or services. Traditional promotional methods like advertising in magazines or on TV are no longer as effective as before. How can a company help their brand stand out? What will make their brand communication effective? In light of these questions and many others, brand experience has emerged as an innovative and compelling way to build a brand in the minds of consumers.

In this paper we will discuss various dimensions of experiential branding and provide insights to strategical aspects of experiential branding in business in order to discover how this branding activity can be used to build the organizations successfully.

Keywords: Experiential Branding, Branding Strategies, Brand Building, Brand Feelings

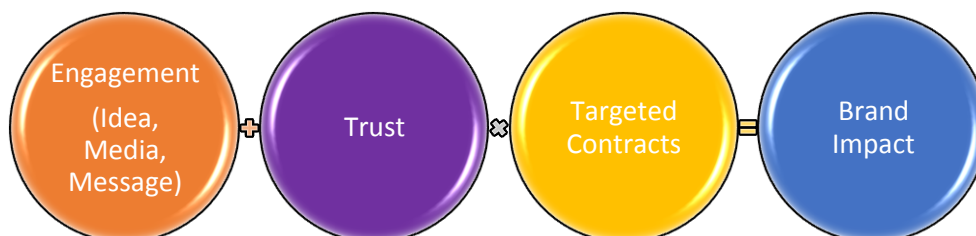
# DEVELOPING ORGANIZATIONS THROUGH EXPERIENTIAL BRANDING FOR SUSTAINABILITY

## 1. INTRODUCTION

Experiential branding is a process by which brands create and drive sensory interactions with consumers in all aspects of the brand experience to emotionally influence their preferences and to actively shape their perceptions of the brand. Interactions involve communication, brand space, and product and service elements. These elements work together to affect brand equity.

Experiential branding, a creative branding process through customer experience, contributes to brand differentiation, esteem, relevance, and knowledge, and therefore it is an effective way to build brands. Through interactive technologies, innovative retail spaces, and indirect online brand communication methods, consumers can now see, touch, hear, taste, and smell brands in ways they never could before. Flashy advertising and price-slashing product promotions are often not sustainable methods for brand building. Experiential branding, with the objective of building brand equity, has emerged as a promising and viable alternative.

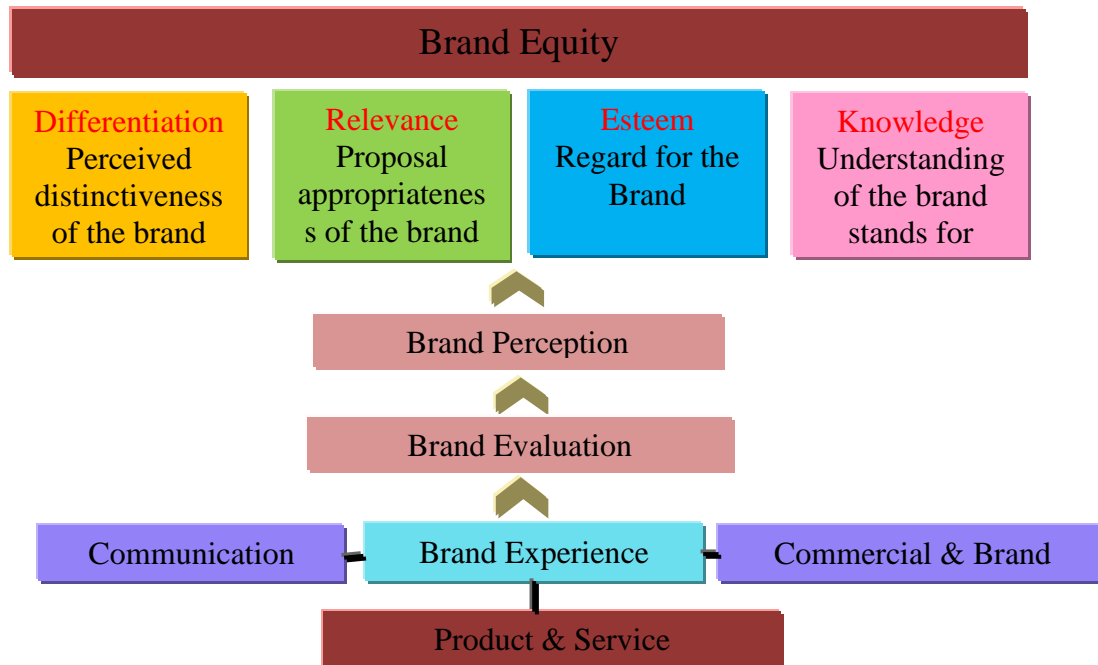
Brand experience can be thought of as sensations, feelings, perceptions, and behavioural responses evoked by brand-related stimuli. The more powerful the experience is, the stronger the brand impression. Brand experience also affects consumer satisfaction and loyalty. It allows the brand to sell products at a premium and to create competitive entry barriers. If a brand event blends genuine positive emotions within people then they are more likely to associate those emotions with that brand, which is more effective. Consumer Engagement is the ultimate point in which a brand and a consumer connect in order to offer a true experience related to the brand's core values. It is a long term connection that must be enhanced over time. Engagement measures the extent to which a consumer has a meaningful brand experience when exposed to commercial advertising, sponsorship, television contact, or other experience. In March 2006 the Advertising Research Foundation defined Engagement as "turning on a prospect to a brand idea enhanced by the surrounding context". The ARF has also defined the function whereby engagement impacts a brand.



The combination of all interactions with communication, brand space, and product and service elements, make up a customer's brand experience. The customer will then form a brand evaluation and perception based on these interactions. This is what builds brand equity in the consumer's mind, and it is composed of four key dimensions: differentiation, relevance, esteem and knowledge. Various experiential branding methods impact different

dimensions of brand equity, which must be carefully considered by marketers or brand managers when utilizing these methods.

**Figure 1: Experiential Branding Combination**



The brand and the "brand experience" are directly taken to consumers through interactive channels of retail, digital and live events. Rather than wait for the consumer to find it, the brand takes itself directly to the consumer with campaigns that ring on a personal level.

Experiential brands differ from image brands in one important respect: where image brands focus on what the product represents, experiential brands are all about how the product makes the user feels when interacting with the brand. An experiential brand is not always a tangible product, but in many cases is a place or a service which delivers a sensory experience or encounter with the brand. Starbucks is an experiential brand; while the product is coffee and other beverages and food items, the real product is the experience of the store itself.

## 2. DIMENSIONS OF EXPERIENTIAL BRANDING

### A) Differentiation: Perceived Distinctiveness of the Brand

Differentiation is a brand's ability to stand apart from others, and to gain consumer choice, preference and loyalty. It is the degree to which consumers find brand uniqueness. A compelling and memorable brand experience can attract customers' attention and maintain their interest, and therefore contribute to brand differentiation.

In recent years, companies like Nokia, Apple, Barbie, and Gucci have opened flagship stores in China to provide more consumer-brand interaction opportunities. The newly-built

Barbie Store in Shanghai is a 6-floor megastore with a spa, design centre, café and interactive activities designed for girls. It became a hot spot in Shanghai very quickly, with thousands of girls now visiting the store every day. The branded experiences provided by the Barbie store will undoubtedly serve to differentiate the brand from others.

Flagship stores are one way that companies can connect and interact with customers to participate in experiential branding. They are also having places to display limited edition products and unique service experiences, which can communicate the companies' culture and brand values.

### **B) Relevance: Personal Appropriateness of the Brand**

Relevance refers to how meaningful a brand is to their target consumers. Relevant brands are both appropriate and appealing. Niche and growing brands may choose to focus first on differentiation and then on relevance, whereas leading brands will excel on all four dimensions.

Adidas Brand Centre in Beijing is both experiential and meaningful for customers, so it contributes to brand relevance. The retail centre features a range of interactive zones including MI Coach Core Skills, the recently launched MI Originals, mi Adidas, a juice bar, a dedicated 'Urban' area for exhibitions and events, a basketball court on the rooftop, a Concierge Desk and a children's area. As you can see, there are products and interactions offered for Adidas' various targeted market segments, ensuring that the customer's experiences of the Adidas brand are highly relevant.

### **C) Esteem: Regard for the Brand**

Esteem measures the degree to which the target audiences regard and respect a brand—in short, how well it is liked. When companies grow larger and become more mature, brand esteem becomes more and more important. Today, companies often use indirect experiential branding methods to build brand esteem. One way to do this is through the Internet and social networking websites.

With the recent popularity of social networking services (SNS) such as Facebook, Twitter, LinkedIN, Renren, and many more, forward-thinking companies place their brand inconspicuously in the pages, games, and posts, of these sites. SNS websites are a new media which stimulate increased interaction with users. In the first half of 2009, Kaixin001 became China's most popular SNS with over 83 million registered. Brands, media agencies, and organizations have used different approaches to connect with the community and target its netizens. It successfully promoted its brand in the popular SNS game "Kaixin Garden". Through this interactive game, the juice brand not only promotes its products, but also portrays a lifestyle and an attitude which influences the customers' brand perception.

### **D) Knowledge: Understanding of the Brand Standing**

Knowledge determines whether there is a true understanding of what a brand stands for. Brand awareness is a sub-component of knowledge. The level of brand knowledge is a signal of the company's past performance, as well as a foundation for its further development. Positive and accurate understanding of the brand amongst target consumers results in brand loyalty. However, it is not enough for a brand to tell consumers what their

brand means, they have to show them, and what better way to do this than through brand experience.

This is what Nokia is doing with its global customer service and experience centre in Shanghai. The centre provides hardware repair and software services to users of its mobile phones. The Shanghai experience centre is a place for customers to learn more about their Nokia cell phones and experience what Nokia brand stands for. Helping their customers develop a deep and comprehensive understanding of their company will help Nokia consolidate their customer loyalty and brand equity.

### 3. ONLINE EXPERIENTIAL TOOLS

We believe that, people embrace what they create as advanced economies, values of society and the individual change. At the heart of this is the key issue around identity and belonging. We have always had community. However, in a post-modern world we can have many selves, as we undertake a quest for self-identity. With the help of modern technological tools we can create a sustainable experiential brand in the market.

**Blogs:** For engagement marketing purposes, companies can share content on their own blogs and participate as a commenter or content provider on relevant external blogs. Hosting a campaign that gives prizes to the readers of external blogs for their participation in some kind of contest is an example of an engagement marketing campaign aimed at external blogs.

**Social networking sites:** Social networking sites (such as Facebook, LinkedIn, and Twitter) are ideal for engagement marketing because they provide a way for people to interact with brands and create a two-way dialogue between customers and companies. Most companies maintain a presence on several of these sites.

**Webcasts:** Differing from internal webcast meetings with a small, specific invitation list, engagement marketing online events are aimed at a much larger and public audience. They are typically available live or on-demand, which allows viewers to view content on their own schedule.

**Email campaigns:** One of the earliest online engagement marketing tools, email marketing requires target audiences to opt-in to directly receive a marketer's emails. Companies can also encourage individuals to share their messages virally, via the forwarding of emails to colleagues, friends and family.

**Crowdsourcing:** Crowdsourcing sites offer engagement marketing opportunities through their open media contests. Crowdsourcing sites like these generate brand ambassadors as an organic by-product of the crowdsourcing process itself by encouraging users to share their submissions on various social networking sites. By first engaging fans and consumers in the act of shaping the brand identity itself, there is increased brand awareness and development of brand relationships well before launching any official media campaign.

#### **4. SOCIAL EXPERIENCIAL BRANDING**

Increasingly we are living in a digital world, social media and the internet is now so ingrained into our lives that at times, For marketers the challenge is to make social media work with other channels, particularly experiential marketing, which requires campaigns that can take the offline online and vice versa. Experiential marketing and social media can be a match made in heaven. To achieve effective integration it is vital to plan precisely how each channel will benefit the other. It's not enough today to purely bolt on a social media element to your experiential campaign. Ultimately it requires an integrated approach, which strives to align the objectives of each channel during the early planning phase.

The extensive nature of social media has driven change and will continue to do so. "A lot of what we're doing focuses around how we can ensure that the experience is something that a person will want to share with their friends, and almost give a positive endorsement to the brand as a result of that experience". As social media has become a daily part of consumer's lives, it has enabled experiential to have a longer lifeline, it has always been about consumers interacting and connecting with your brand.

Experiential marketing has talked a lot about the "amplifier" effect of social media. Increasingly, experiential marketers are looking at social media as a way to initiate campaigns, using social media interactions as triggers for experiences. The value of social media is having a well-defined target audience congregated in a common place online, whilst experiential can help to engage with this audience in the real world. Combined, these channels have the potential to deliver fully integrated marketing that drives engagement, positive sentiment and ultimately brand recognition and sales.

However, the media space has become much more cluttered, and brands have recognised that they can create a unique and valuable experience, a proper interaction between the consumer and brand. Technology and social media have become enablers for experiential to be recognised as a valid media channel in its own right. "In the past, experiential possibly wasnot considered when brands were looking at their communications strategy," However, over the past five or six years, it has very much been understood and recognised that an experiential campaign or in our language, the actions of a brand can in fact sit at the absolute heart of a communications platform.

#### **5. EXPERIENCIAL BRANDING ENVIRONMENT**

Experiential branding is the thoughtful application of brand to every point of contact with the market. Beyond business cards and letterhead, experiential branding is combining design disciplines of graphic, architectural, interior, landscape, and industrial to communicate identity, information, and the idea of place. Presentations go beyond the ordinary to create extraordinary visual branding elements that extend the marketing and communications of non-profits and corporations.

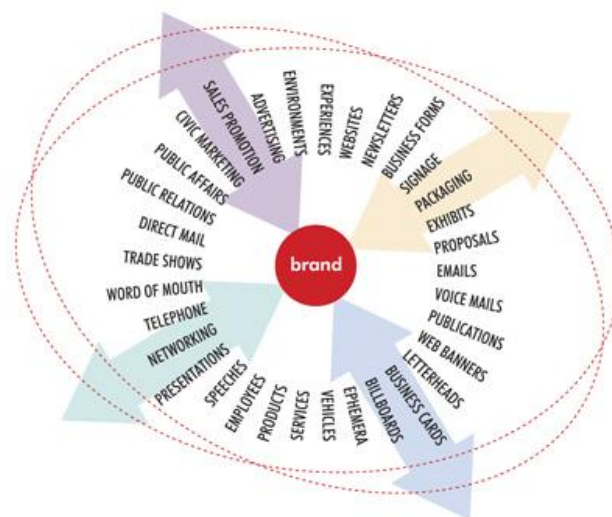
##### **Extension and Differentiation in Experiential Branding**

By extending a brand into all internal and external environments of a space it can promote sensory perceptions of a non-profit or corporation. When your employees

understand your vision and mission they are better at self-promotion and are more loyal. Visual keys are an easy way to promote brand awareness on a daily basis. Your clients, visitors and employees will know who you are the moment they enter your campus or open a brochure.

Touchpoints are the specific experiential branding contact opportunities to strengthen brand and communicate identity. There are thousands of opportunities each day to contact your market. Taking advantage of all of them will reassure an increase in market share and build brand equity among employees, vendors, clients and visitors. Presentations brings cohesion and innovation to all of the touchpoints, making sure they all work together and deliver the same solid message.

**Figure 2: Brand Touchpoints**



Source: Alina Wheeler, C (2006) from <http://www.p-egd.com>)

Competition for recognition is tough in today’s market and it extends to the airwaves and cyberspace too. A business can increase brand awareness, promote loyalty and differentiate itself from competitors in the market by using experiential branding. Experiential branding makes you stand out from the crowd with a focus on a strong brand message.

Experiential branding is a different approach to your business. More than experiential marketing, which is a tactic, experiential branding is a philosophy of business that demands the organization be actualized and all processes aligned to the final customer experience. A powerful brand is one that can be more than just seen—it can also be smelled, tasted, touched and heard and is expressed at every touch point. An experiential brand creates a much deeper level of engagement because it creates a complete experience that envelopes its audience.

The dimensions of an experiential brand are primarily its potency (intense or mild) and its activity (passive or active). Most experiential brands deliver a positive experience (think Disney or Elizabeth Arden salons) but vary in the intensity of the experience as well as the activity involved. Managing experiential brands are primarily a challenge of consistency.



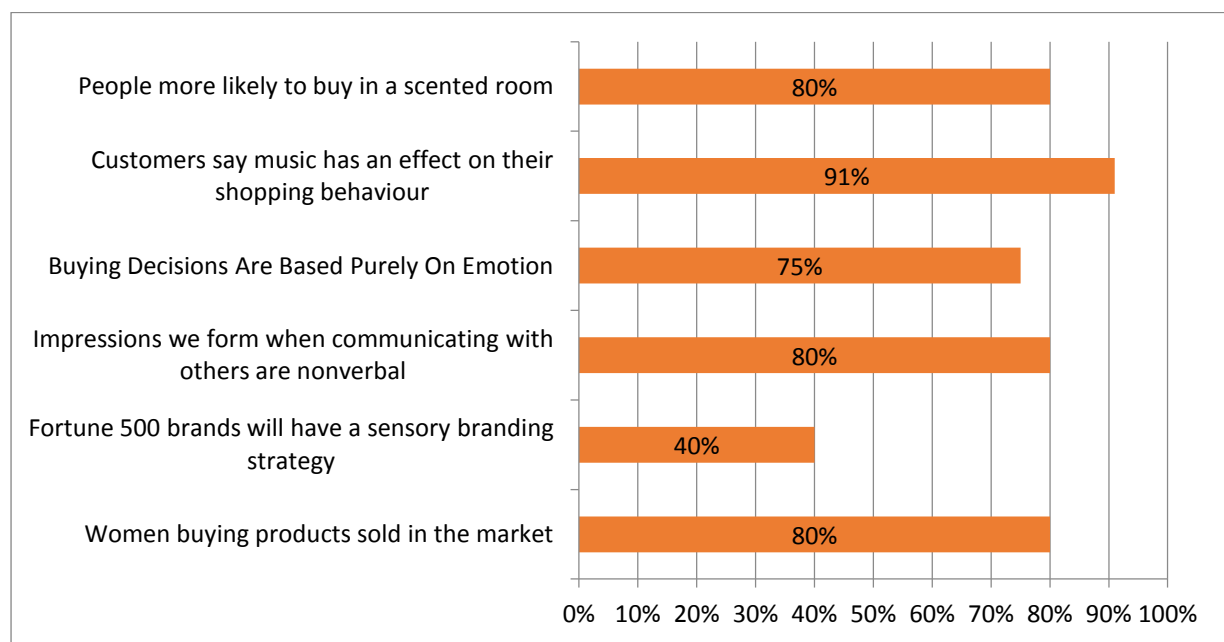
Starbucks takes great care when hiring and training employees to assure a good cultural fit and the ability to convey the brand values and deliver on the brand experience. Disney, too, is known for the care it takes in hiring, training, and managing employees, as well as maintaining the spotless and cheerful tamps of the parks.

There is a growing understanding of the need for a smarter, integrated and digital approach to consumer interaction. "Experiential branding pertains to the overall look and feel of a brand. The main goal of experiential branding is to form a memorable and emotional connection between the consumer and the brand so that it may generate customer loyalty and influence purchase decisions. And when a consumer has an unforgettable experience with a brand first-hand, whether it may be through an advertisement, a product trial, an opening event, he or she is more likely to do business with the brand and spread the word to family and friends.

## 6. EXPERIENCIAL ATTRIBUTE ANALYSIS

Smell is arguably the strongest of senses. There are more connections between the olfactory regions of the brain to the place where emotional memories are processed than any of the other senses we have. 75% of our emotions are generated by smell (women are more sensitive to smells than men). It has been observed that,

- *Women buy 80% of products sold in the market.*
- *It's estimated that 40% of fortune 500 brands will have a sensory branding strategy.*
- *80% of all the impressions we form when communicating with others are nonverbal.*
- *75% Of Buying Decisions Are Based Purely On Emotion.*
- *91% of customers say music has an effect on their shopping behaviour.*
- *84% of people in a study said they were more likely to buy in a scented room.*



### **Interpretation:**

Experiential branding has a larger impact on consumers and it an appealing strategy for the organizations to attract and influence more customers to sustain in the market. Hence, Experiential Branding Strategy helps the organizations to develop, sustain and succeed in the competition.

## **7. THEORY DISCUSSION**

Experiential branding is related to and influenced by numerous theories within a range of different marketing disciplines and in this section the most important of these theories will be briefly introduced.

**Experience Economy:** In “The Experience Economy” Pine and Gilmore (1999) suggested that western societies and still are in the process of evolving from a service economy to an experience economy, characterized by an increasing demand for staged experiences related to goods and services. They argue that companies in relation to this societal change should change their focus to the selling of experiences with their products and services as props and a stage, charging admission for participation in the experience only.

**Branding Theory:** Changing strategic focus towards experience based marketing will be highly influenced by branding theory as the premises for brandbuilding are the same as for any other type of campaign. Customer Based Brand Equity model (CBBE) and the Brand Value Chain (Keller 2008) can be used to evaluate experiential branding as a brand equity building strategy.

**Experiential Marketing:** Schmitt (2009) did suggest an experiential approach to creating marketing strategies. However, he put great emphasis on the use of traditional media to create experientially driven advertisements. The use of traditional media is putting ever increasing limitations on the possible effectiveness of campaigns, limiting the potential effectiveness of direct application Schmitt’s work.

**Event Marketing:** In their writings on event marketing, Whelan and Wohlfeil (2006) take an experience staging approach to their analysis of events as a tactical marketing tool. They provide an analysis of target group motivations to participate in marketing-events and demonstrate the effectiveness of experiential campaigns.

**Authenticity:** Experiential branding is based on the premise that a company will build brand equity through engaging its target group with real lived experiences at planned events. However, for this to actually be an efficient branding strategy it is essential that the target group perceives coherence between the brand and the content of the event.

**Brand feelings:** It is a customer’s emotional responses and reactions to the brand.” (Keller 2008) and are typically related to the brand imagery, hence creation of positive brand feelings will be a main objective of experiential branding campaigns. Keller references six important types of brand feelings, being Warmth, fun, excitement, security, social approval and self-concept. Successfully triggering these brand feelings as positively as possible is paramount in building strong brand (Keller 2008) equity and successful incorporation of these results in

customers internalizing the positive feelings (and judgments), experiencing them when thinking of or using the brand.

**Brand Resonance:** Brands gain a high degree of salience and present customers with positive aspects of brand imagery and performance, eliciting positive brand judgments and feelings; they have the potential for attaining brand resonance with the customer. Brand resonance is mainly into four categories with an increasing level of involvement with the brand: Behavioural loyalty, attitudinal attachment, sense of community and active engagement. The presence of customers with a degree of brand resonance is a marker of strong brand equity and should be the ultimate goal of marketers

There is a rise of experientially driven business strategy on the basis of personalization of goods and service offerings. Likewise the ubiquity and impersonality of traditional advertisement has resulted in lessened attitudes towards it. As consumers respond with an increased demand for personally engaging experiences in the face of commoditization of goods and services, the same must be true when advertising becomes commoditized. In this sense. Experiential branding will serve to provide consumers with real lived experiences, staged by companies, as a means of building brand equity.

#### **Benefits of implementing an experiential Branding Strategy**

- Generate awareness
- Create an emotional connection
- Develop positive perceptions
- Show off its attributes
- Gain credibility
- Guide preferences
- Stimulate purchases

Experiential branding helps for engaging people as they interact in and with their environment. It is the practice of communicating a brand through a combination of graphic, architectural, interior, media, landscape and industrial design. Experiential branding connects people to places through distinctive, informative and memorable experiences.

A powerful brand is one that can be more than just seen but it can also be smelled, tasted, touched and heard and is expressed at every touch point. An experiential brand creates a much deeper level of engagement because it creates a complete experience that envelops its audience. Smell is arguably the strongest of senses. There are more connections between the olfactory regions of the brain to the place where emotional memories are processed than any of the other senses we have. 75% of our emotions are generated by smell (women are more sensitive to smells than men).

Experiential branding: beneficially differentiating a product or service in somebody's mind by focusing on the totality of the experience, rather than focusing on the features, attributes or benefits of the product

Brand integration: The process of ensuring that the brand essence is consistently reflected in all aspects and consumer touchpoints of the brand

- Operations: an integrated brand is reflected in everything the company does

- Communications: an integrated brand is expressed consistently in everything the company says
- Integration: It starts with the realization that the brand underlies the overall business strategy and therefore needs to be clearly defined and consistently explained to all aspects of the business, from the outset

Champions of successful integrated brands think of the brand as the business equivalent of pre-linguistic, pre-behavioural determination - the company's superego that informs everything it is and does. So, developing a detailed plan to address all aspects of the branding pyramid is critical in order to achieve brand resonance. And, once brand resonance has been achieved, constant vigilance is necessary to maintain that position in the minds of those who experience your brand. At that point, the payoff can be significant.

## **8. BRAND JUDGMENTS AND FEELINGS**

Brand performance and imagery are evaluated by the customer, forming brand judgments and feelings. Brand judgments are the sum of customer evaluations on all aspects of the brand, both in terms of performance and imagery.

In particular four main types of judgments are essential:

- Brand Quality
- Brand Credibility
- Brand Consideration
- Brand Superiority

Brand quality naturally refers to the perceived customer value of the brand and is rated in relation to competing brands.

Brand credibility describes customer perceptions of the brand in relation to perceived expertise, trustworthiness and likeability (Keller 2011). This aspect of brand evaluation is closely related to the concept of authenticity. In relation to experiential branding campaign planning, this will be a key aspect as customers in this case must perceive not only the brand as being credible and authentic, but also the experience staged by the brand.

Brand consideration is defined as the percentage of consumers who would consider your brand for a given purchase occasion.

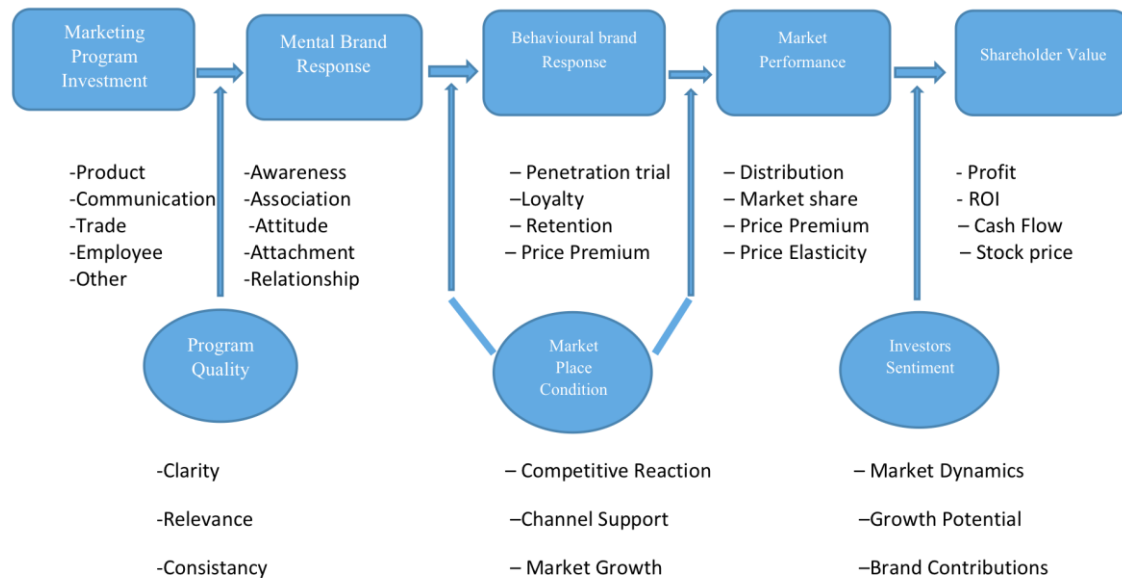
Brand Superiority is semantic differentials which are used to measure the degree to which a person believes that the information to which he/she has been exposed describes a product and its features in a positive manner and indicates it is better than the competition.

Judgment & Feeling are critical because it's the bridge between the feature and resonance levels. Users of your brand form important judgments and feelings about your brand based on its performance and imagery. If your brand's performance is sub-par, your users' judgments and feelings will reflect that, never allowing you to achieve brand resonance in their minds.

## 9. BRAND VALUE CHAIN

When marketers create marketing campaigns it is done with an expectation of the investment having a positive effect for the brand and often much emphasis is put on financially measurable effects overlooking the importance of the brand equity building effects. The brand value chain can be used to understand and interpret the effects of marketing investment by tracing the value creation through five value stages

**Figure 3: Brand Value Chain**



This five staged brand value chain enables the use of behavioural response effects to be evaluated and further it makes a more distinct connection. Maximizing customer mind set effects ensures optimal premises for creating behavioural brand response such as trial, repeat purchase, increasing retention and creating loyalty.

The behavioural brand response is the unleashing of the brand equity built through mental brand responses, releasing it into cash flow. The effects of the behavioural value stage are influenced by marketplace conditions.

Brand Value Chain will be used to explain how experiential branding can contribute to value creation. Focus will mainly be on the value stages as these stages and multipliers are closer, and more directly related to the influence of experiential branding initiatives.

## 10. EXAMPLES OF EXPERIENTIAL BRANDING

Brands exist only in the minds of consumers. They are intangible and as such rely on marketers for linguistic interpretation: definitions that accurately describe the mental pictures that the brand conjures or should conjure up. In order to accomplish this effectively, we need first to develop the learning (inputs) that will help us crystallize an understanding of what the brand is (the brand essence). Following this, we need to describe the essence in a common

language that gives clear direction to all stakeholders to ensure consistency at every touchpoint (outputs). Finally, we need to develop and execute implementation Brand integration strategies to activate the brand (activation).

- Samsung: As part of its sponsorship of the 2012 Olympics, Samsung created brand experiences at various destinations around London
- Doc McStuffin's: Children were given a 10-minute immersive experience where they took the role of Doc and diagnosed what was wrong with Big Ted.
- Adidas: Derrick Rose was in attendance to challenge fans to win a pair of free trainers by taking them off a shelf that happened to be 10 foot in the air.
- Mountain Dew: A team of 15 brand ambassadors drove around the UK in a Mountain Dew truck, hosting various competitions and giveaways.
- Sensodyne: 'The Great Sensitivity Test' was setup near London's Tower Bridge. They allowed people to have a sensitivity check with a dentist, win prizes, obtain free samples and see a demo of the product.
- NATIONAL GEOGRAPHIC - "Augmented Reality"
- MERCEDES-BENZ - "Looks fast. Even in park."
- SPANAIR - "Unexpected luggage"
- TROPICANA - "Brighter mornings for brighter days"
- COCA-COLA - "The Coca-Cola friendship machine"
- FOX CRIME - "Interactive Billboard"
- GRANATA PET STORE - "Snack Check"
- VOLKSWAGEN - "The fun theory"
- Dove: ChooseBeautiful

Experiential Branding helped the organizations to develop and sustain in the competitive business environment.

## 11. CONCLUSION

Experiential branding is a creative branding process through customer experience, contributes to brand differentiation, esteem, relevance, and knowledge, and therefore is an effective way to build brands. Through interactive technologies, innovative retail spaces, and indirect online brand communication methods, consumers can now see, touch, hear, taste, and smell brands in ways they never could before. Flashy advertising and price-slashing product promotions are often not sustainable methods for brand building. Experiential branding, with the objective of building brand equity, has emerged as a promising and viable alternative.

The purpose of this paper has been to provide a means for a possible future validation of the effectiveness of experiential branding through constructing a framework for strategic planning and effects measurement hereof in relation to maximizing the building of brand equity. Above we concluded that the guide for this strategic planning could realistically be implemented in marketing practice through an evaluation of its coherence with current best practice. Future research seeking to document the potential effectiveness of experiential branding in terms of building brand equity with both participants and non participants at events, may hence be conducted.

The impact of experiences on brand equity with the brief description of the premises for commercial and marketing experience provides some clue as to how experiential branding can be employed to build brand equity. It is uncertain how the use of experientially driven marketing will develop in the future, however we expect to see an increased focus on experiential branding and expect to see more versatile variations. Further, we argued that the composition of experiential branding should be based on the following:

- Sense
- Feel
- Think
- Act
- Relate

Through this we conclude that experiential branding is good strategy to optimize the building of brand. Company should strive to include as many experiential dimensions as possible and identify on or more relating specifically to product/service for development and sustainability

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# **IMPLICATIONS OF KNOWLEDGE BASED ECONOMY POLICIES IN SLOVAKIA**

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## **ABSTRACT**

The knowledge is now recognized as the driver of productivity and economic growth, leading to a new focus on the role of information, technology and learning in economic performance. In industrial economy the competitive advantage was access to raw materials, cost reduction through economies of scale and cheap labor. In knowledge economy it is distinctive capabilities, institutional excellence, moving with speed, human resources and customer partnerships. Each country that wants to grow and compete in the international market must be knowledge based and move towards fully developed Knowledge Based Economy. The process of change from industrial economy to knowledge based economy can be speed up in sufficient environment that supports innovations and entrepreneurship. Government plays an important role in the process of transformation of the national economy. Therefore the economic policies of the state must be wisely set up and implemented. Main purpose of this article is to show how successfully implemented policies can help a country to become modern knowledge based economy. First part deals with some theoretical aspects and different view on definition of knowledge based economy. The second part of paper is focus on main policies that countries have made in order to become knowledge based economy. Policies supporting entrepreneurship, inflow of venture capital, development of human capital and innovations are deeply analyzed. Slovak economic growth is one of the highest within the last years in the EU and there are several Slovak entrepreneurs who has achieved on the international markets. In the times when the EU is shaking and it is not clear what will happen with “less-prominent” countries, Slovakia should step up and take its destiny into its own hands. The result of the paper is brief proposition of main strategies Slovakia could implement in order to move more effectively to developed knowledge based economy.

**Keywords:** Knowledge-based Economy. Technological Incubators. Innovations. Entrepreneurship. Human capital.

# IMPLICATIONS OF KNOWLEDGE BASED ECONOMY POLICIES IN SLOVAKIA

## 1. INTRODUCTION

Over the past several decades the leading edge industries within developed countries has become driven by technologies based on knowledge and information production. It is neither the physical inputs nor natural resources the economy depends on. The key component of the economy is a greater reliance on intellectual capabilities. Since the word *knowledge-based economy* also cited as a *knowledge economy* is rather a broad and complex term and needs a deep explanation.<sup>11</sup> The OECD (2005) defines the knowledge-based economy as following: “*The knowledge based economy is an expression coined to describe trends in advanced economies towards greater dependence on knowledge, information and high skill levels, and the increasing need for ready access to all of these by the business and public sectors*”. This definition is quite broad and some of the critics, for example Keith Smith (2002) argue that the definition is rhetorical rather than practical. The literature does not even give a clear explanation what *knowledge* is. At one extreme, knowledge requires a transformative internalizing of some new principle, and at the other it simply involves accessing an intelligible account of how to do something. Smith defined four basic views about the changed significance of knowledge:

1. Knowledge is quantitatively and in some sense also qualitatively more important than before as an input.
2. Knowledge is in some way more important as a product (trading knowledge products),
3. Codified knowledge is in some ways more significant as component of economically relevant knowledge bases.
4. The knowledge economy rests on technological changes in information and communications technology.

Some other definitions refer to knowledge based economy as following:

“*The knowledge society is a larger concept that just an increased commitment to R&D. It covers every aspect of the contemporary economy where knowledge is at the heart of value added – from high tech manufacturing and Information and communication technologies (ICTs) through knowledge intensive services to the overtly creative industries such as media and architecture*“(EurActiv, 2004).

“*Economic success is increasingly based on upon the effective utilization of intangible assets such as knowledge, skills and innovative potential as the key resource for competitive advantage. The term “knowledge economy” is used to describe this emerging economic structure*” (ESRC, 2005).

To summarize, knowledge based economy is characterized by high and growing intensity of ICT usage by well-educated workers. It is present in all sectors of economy and consists of innovating organizations.

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<sup>11</sup> This paper is based on master's thesis The knowledge-based economy the Israeli example and its implication in Slovakia. led by Marcel Novak and written by Katarina Minarikova.

## 2. HOW TO MEASURE KNOWLEDGE BASED ECONOMY

Measurement of all indicators regarding to the knowledge based economy would be too challenging, the OECD (2001) released the two-year Growth Project report, *The New Economy: beyond the Hype*. The report emphasized the importance of a stable and open macro-economic environment with effectively functioning markets; the diffusion of ICT; fostering innovation; investing in human capital; and stimulating firm creation.

The Asia Pacific Economies, (APEC (2000)) developed mythical economy called *Nikuda*. It represents fully developed and idealized knowledge based economy and examines the economies within four dimensions (Human resource development, Innovation system, ICT infrastructure and Business environment).

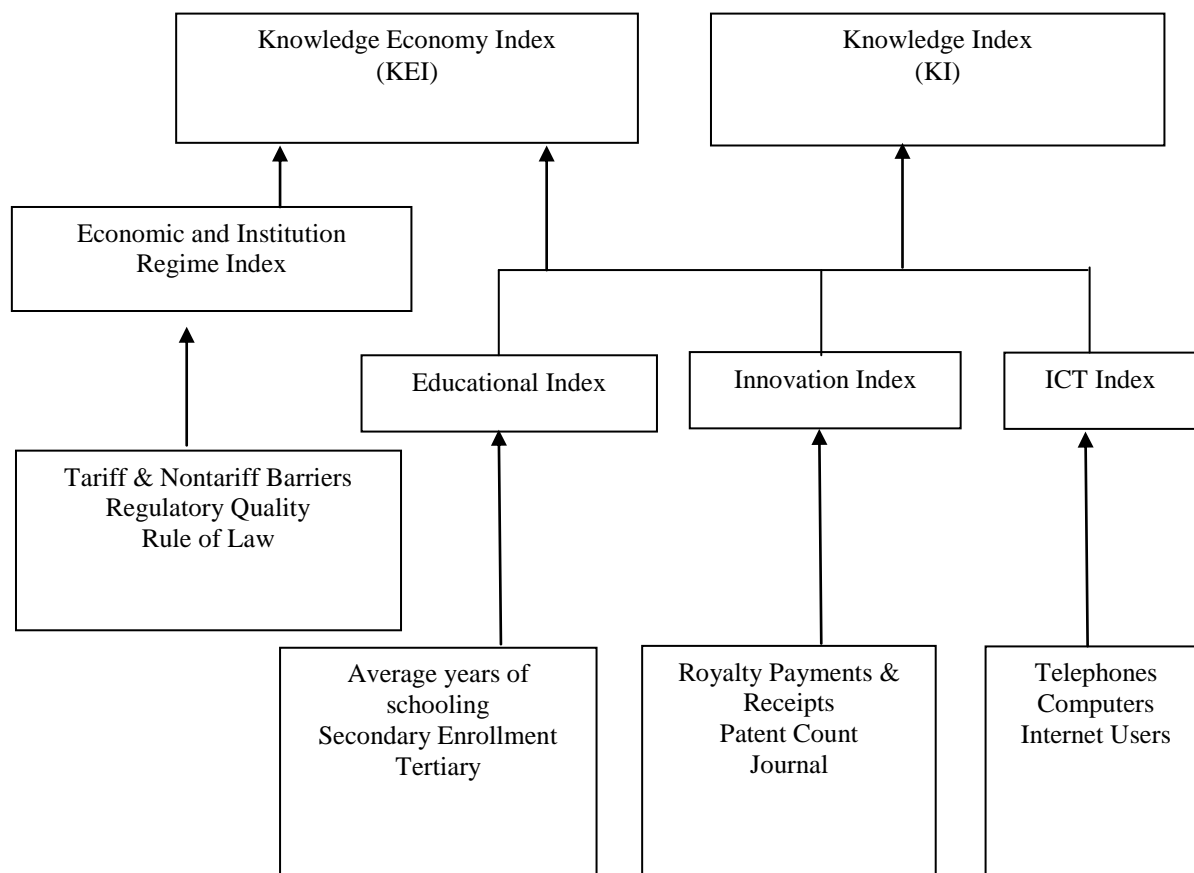
The European Commission introduced the European Innovation Scoreboard (2014). It provides a comparative assessment of the research and innovation performance of the EU Member States and the relative strengths and weaknesses of their research and innovation systems.

The World Bank Institute launched in 1999 a project called Knowledge for Development (K4D). Its aim is to raise awareness among policymakers about the effect of knowledge. The World Bank (2012) proposed the *Knowledge Assessment Methodology* (KAM) for measuring the knowledge development.

The KAM consist of 148 structural and qualitative variables for 146 countries to measure their performance on the four Knowledge Economy pillars: 1) Economic Incentive and Institutional, 2) Education, 3) Innovation and 4) Information and Communications Technologies.

The KAM Knowledge Index measures a country's ability to generate, adopt and diffuse knowledge. This is an indication of the overall potential for knowledge development in a given country. Methodologically, the KI is the simple average of the normalized performance scores of a country or region on the key variables in three of the knowledge economy pillars – education and human resources, the innovation system and ICT. The Knowledge Economy Index takes into account whether the environment is conducive for knowledge to be used effectively for economic development. It is an aggregate index that represents the overall level of development of a country or region in relation to the knowledge economy.

**Figure 1: Knowledge Economy Index (KEI) and the Knowledge Index (KI)**



Source: [www.worldbank.sk](http://www.worldbank.sk)

**Table 1: Knowledge Economy Index (KEI) 2012 Rankings (145 countries)**

Country	KEI Rank	KEI
Sweden	1	9,43
Finland	2	9,33
Denmark	3	9,16
Netherlands	4	9,11
Norway	5	9,11
New Zealand	6	8,97
Canada	7	8,92
Germany	8	8,9
Australia	9	8,88
Switzerland	10	8,87
Slovak Republic	33	7,64
Thailand	66	5,21

Source: KAM (2012) from [www.worldbank.org/kam](http://www.worldbank.org/kam)

### 3. GOVERNMENT SUPPORT OF KNOWLEDGE BASED ECONOMY

Countries all around the world realize they need to move forward knowledge based economy in order to increase their income and prosperity. The main responsibility of the government is to create an environment that supports innovations and knowledge-spreading. Different countries use different incentives in order to do so. All OECD economies are in more or bigger extend developed knowledge based economies. According to Steven White (2012), the US became knowledge based economy in 1997 when 50.74 percent of all U.S. services exports consisted of knowledge-based services. The USA had predisposition to be one of the first knowledge based economy thanks huge support of free market and competitiveness which accelerated development of new technologies, innovations and supported creativity among people. The European Union (European Commission, 2010) launched in 2010 strategy Europe 2020. The main goal of this strategy (European Commission, 2010) is to deliver growth that is: *smart*, through more effective investments in education, research and innovation; *sustainable*, thanks to a decisive move towards a low-carbon economy; and *inclusive*, with a strong emphasis on job creation and poverty reduction. The strategy focuses on five ambitious goals:

1. *Employment* – 75% of the 20 – 64 year-olds to be employed.
2. *R&D* – 3% of the EU's GDP to be invested in R&D.
3. *Climate change and energy sustainability* – 20% of energy from renewables, 20% increase in energy efficiency and greenhouse gas emissions 20% lower than in 1990.
4. *Education* – at least 40% of 30 – 34 years-olds completing third level education and reducing the rates of early school leaving below 10%.
5. *Fighting poverty and social exclusion* – at least 20 million fewer people in or at risk of poverty and social exclusion.

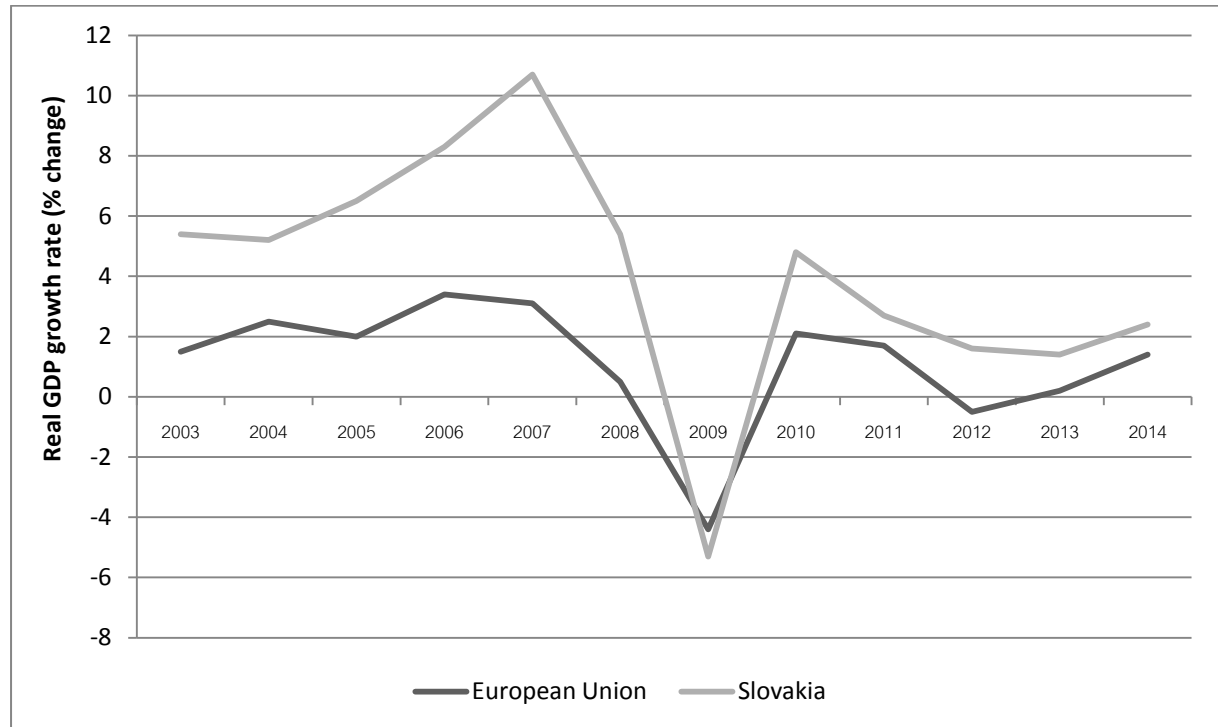
To fulfill these targets, the European Commission announced main initiatives that are support by the EU budget. The member states are obligated to meet their goals and promote the agenda within the country. In 2013 Australia launched new Economic reform (CPA Australia, 2010) focused on more competitive and productive Australia. The reform priorities should help to build a knowledge-based economy on its four principles. Also countries which are not part of OECD group work toward more innovative and knowledge-based approaches in their economy. Asian development Bank (2010) encourages their member states to advance their policies toward more developed knowledge based economy in a study called *Innovative Asia: Advancing the Knowledge-Based Economy*. United Arab Emirates launched in 2010 Vision 2021 (2010). One of its priorities is more competitive knowledge economy. The strategy focuses on development of non-oil real GDP growth, support of SMEs, innovation, knowledge workers etc.

### 4. IMPLICATION OF KNOWLEDGE BASED ECONOMY IN SLOVAKIA

As we have already mentioned at the beginning of the paper, Slovakia is young country that has made huge progress in the last 20 years regarding to decentralization of the economy and building its market economy. Since 2010 Slovak economy has been growing much faster than the EU average - Slovak economy grew 2.4% while the EU grew only 1.3% in the 2014 (Figure 2). Slovakia has built developed industrial economy able to compete

within the EU. However the 21<sup>st</sup> century is a century of knowledge and innovation. Therefore, it is necessary for Slovakia to move towards the knowledge based economy in order to compete on international markets in the future.

**Figure 2: Real GDP growth rate (% change on previous year)**



Source: Eurostat, authors

According to the analyses of knowledge based economy we made in the previous part of the paper, we are proposing brief strategy that could be implemented by Slovak government in order to move towards developed knowledge based economy. The goal of this part of the paper is not to propose detailed policies that could be implemented. It's rather a proposal for the main strategies and way that could Slovakia take. The detailed description and implementation of the policies is a subject for further discussion.

#### 4.1 The Role of Government

Government plays an important role in leading the nation towards knowledge based economy. The "top-down" approach has been implemented. Government decided to strengthen entrepreneurship, start-ups and innovations, and therefore focused its policies on long-term support of those areas. Government decided country's comparative advantage would be high-skilled (knowledge) workers and entrepreneurship, so it started to invest in R&D and programs related to innovations, investments and venture capital. Government was in the role of accelerator of change and stood up in a position of risk taker to prepare the way for private investors and entrepreneurs. On the other hand, the decision to leave the market for private players was made in the right time. When the market was prepared, Successful government left the space for privatization and private players. Very important fact is that the policy changes haven't lasted just one election period, but they were continuous. Therefore the policies have brought expected results. To achieve such a continuous policy there must

have been set up long-term goals that were supported by wide public and majority of political parties.

Slovakia is young state and it seems like it's still trying to find its way. Shifts between right-hand democrats and social democrats in governance have caused changes in priorities and amount of financial support for entrepreneurship. Slovakia's comparative advantage is cheap skilled workforce. Therefore at the 1990s government supported inflow of big transnational companies that needed cheap qualified workers. At the end of 20<sup>th</sup> century was this step inevitable to decrease unemployment and start up market economy. However 20 years later it may not be the best strategy. Some Slovak governments have supported entrepreneurship more, some less. Strategic role plays not only the direct support of entrepreneurs but also cultivation of entrepreneurial environment. When the bureaucracy is too complicated and taxes too high, the willingness to start enterprise is decreasing. The long-term strategy of European Union is to support Small and medium enterprises (SMEs). There are several EU programs that afford financial support to these entrepreneurs. According to European Commission (2015), more than 99% of all European businesses are SMEs. They provide two out of three of the private sector jobs and contribute to more than half of the total value-added created by businesses in the EU.

Even though the EU strategy for SMEs is favorable, since the social-democrats came to power in 2012, the situation for SMEs and entrepreneurs in Slovakia has worsened (FINSTAT, 2014). The corporate tax has risen from 19% to 23%, the mandatory social and health insurance has increased and since 2014 firms must pay so called "tax license" even if they get loss (41,2% SMEs got zero or loss in 2014). Because the tax increase by 4% didn't bring expected amount of money in public finance government decided to decrease the tax on 21%. It seems like the main goal of the government is to secure income to the public budget rather than cultivate environment for entrepreneurs. In Slovakia SMEs (also with self-employees) employed 59% of all employees in 2012. There are also some very successful Slovak high-tech companies competing in world market (ESET, Sygic). Recently the aeromobile was developed and constructed by Slovak engineers. These examples prove there is a potential to develop innovative companies in Slovakia. On the other hand, the government supports big transnational companies by giving them subsidies, state aid, and tax vacations. Just in 2012 got twelve big firms tax relief more than 120 mil euros (TASR, 2012). These big firms are mainly heavy industry companies. There is a risk, that these transnational companies may leave Slovakia as soon as they find cheaper labor force in other countries. The problem regarding to development of knowledge based economy is that the biggest government support goes to manufacturing firms, not businesses focused on high-tech, innovations, and new trends.

If Slovakia would like to successfully move forward knowledge based economy, we see very important that Slovak government would keep these two approaches:

1. *Long-term implementation of knowledge based economy policies* – we recommend also for Slovakia implementation of "top-down" approach where the government is taking the role of supporter of the knowledge based economy environment and risk taker. It is impossible to implement knowledge based economy during one election period; therefore these police must be publicly recognized as priority for Slovakia and be supported regardless on the governing party.

2. *Smart combination of public and private money and control* – government plays a necessary role of implementation the knowledge based economy. However, very important is

to know, when is the right time for the government to leave the space for private players and let them to lead the programs and initiatives. Well-developed private sector is usually more effective than the public.

Regarding the knowledge based economy policies we recommend focus on these four areas: 1) Entrepreneurship support, 2) Education reform, 3) Innovation support, 4) Fight against corruption and 5) Interconnections development. Some of the proposed policies can bring very nice results in short-term period. Some policies required long-term approach and patience.

## **4.2 Entrepreneurship support**

### **4.2.1 Entrepreneurial culture**

The internal motivation of individual “can do” approach and acceptance of failures in society are inevitable for development of strong entrepreneurial culture. Israelis are naturally very assertive, they are constantly looking for new opportunities, see problems as challenges and never give up. Slovak culture is not naturally very assertive, they are not constantly looking for new opportunities, see problems as challenges and never give up. Communism has killed dreams, passion, freedom, self-confidence and willingness to take some risk. Therefore it is necessary to start to gradually build this culture. We see important to:

*1. Use the media* - society should value and appreciate smart and skillful people who are representing Slovakia on the international markets. Their stories should be promoted in media. Media should share successful stories of Slovak businessman and accept also failures. Failures should be represented as an inevitable part of success.

*2. Cooperate with successful Slovak businessman* – every student should have the opportunity to be taught by a person with entrepreneurial practice. Successful businessman should be asked to be involved in education process to share their knowledge and also contacts.

*3. Progress report about Slovak entrepreneurship* – a yearly report made by government which will highlight the most successful entrepreneurs and innovative firms. The entrepreneurs should be awarded by the prime minister or president to feel the support from the government. The government should show Slovak entrepreneurs are valuable for the country and it should emphasize they are the future.

*4. Incorporate entrepreneurship education into the educational system* – already in the primary school pupils should be encourage to critical thinking, to present their ideas. School should give the pupils and students space to realize their own ideas, so the students will have experience they can achieve and change things they are passionate about.

To change the culture of the nation is a long-term process and sometimes need one or two generations till it is fully implemented. Because of that it is necessary to start implementing these policies as soon as possible.



#### **4.2.2 Stop emigration**

The power of economic growth in the most of successful countries has been built on immigration of highly educated and skillful immigrants. Immigration is not really the case for Slovakia; however Slovakia could stop emigration of young educated people from the country. The best Slovak capacities are studying at foreign universities or leaving Slovakia after studies. However Slovak people with experiences from abroad could be the accelerator of economic growth in Slovakia if they get opportunity to realization. Every public institution should have two or three positions where only Slovaks with experiences from abroad can work. They should also get a space to realize the ideas and should get a power to change something. Not every Slovak living abroad will come back to Slovakia. These Slovaks are anyway great asset to Slovakia if they are good connected with Slovak enterprises, universities and public institutions. It is necessary that in a big metropolis such as London, New York, Paris and others where big Slovak communities are and many Slovak students live will be organized conferences to connect these people by the support of Slovak government. Slovak organizations will present opportunities for cooperation with the Students and experienced entrepreneurs or Slovak people at good working positions. Such a conference was already organized in October 2014 in London by private organizations with support of Slovak president. Connections are a necessary asset in the knowledge based economy and Slovaks living abroad are huge advantage for Slovakia. They should get also voting right and still feel welcomed in Slovakia. To organize conferences, safe two or three positions in public institutions for Slovaks with experiences from abroad and give Slovaks in abroad voting rights are cheap and quick solutions that can bring huge impact.

#### **4.2.3 Establishment of Incubator Program**

There already are some public programs that support entrepreneurs in Slovakia, for example the Slovak Business Agency<sup>12</sup> (offering microcredits, advices in tax and legal issues within Slovakia and EU), and the Ministry of Economy (provides some kinds of subsidies for chosen economic areas). However, also the indirect support of Slovak entrepreneurs could be stronger with the emphasis on long-term development of cultivation entrepreneurial environment. Slovakia is still missing programs for support starting entrepreneurs. There are some technological incubators in Slovakia operating mainly in cooperation with universities (University Technology Incubator of STU, VTP Žilina, SPOT, Connect and others). However these incubators doesn't provide such a complex services. Moreover, government is not the guarantee of loans and the risk taker. There is a strong assumption according to Incubator model in other countries, that smart public investments could accelerate private investments and pay the invested money back in taxes of successful companies. The right combination of experienced entrepreneurs and experts who can coach and mentor starting entrepreneurs, and public financial support are necessary for building successful organizations. Government should be in position of risk-taker and developer of safe environment for entrepreneurship and new ideas development. Because there already are some working incubators in Slovakia, government could start to support the existing incubators by the grants that will be paid back if the organization achieve in a long-term. Government could support two or three project each year in each Incubator. The support in next year will depend on the Incubator's quality results from last year, so the money cannot be misused. This can be implemented quickly and can bring nice results.

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<sup>12</sup> **Slovak Business Agency** (till 28/2/2014 the National Agency for Development of SMEs) is crucial, and is the oldest specialized non-profit organization for the support of small and medium-sized enterprises (SMEs). Slovak Business Agency was founded in 1993 by a common initiative of the EU and the Government of the Slovak Republic. It is the unique platform of public and private sectors. <http://www.sbagency.sk/>.

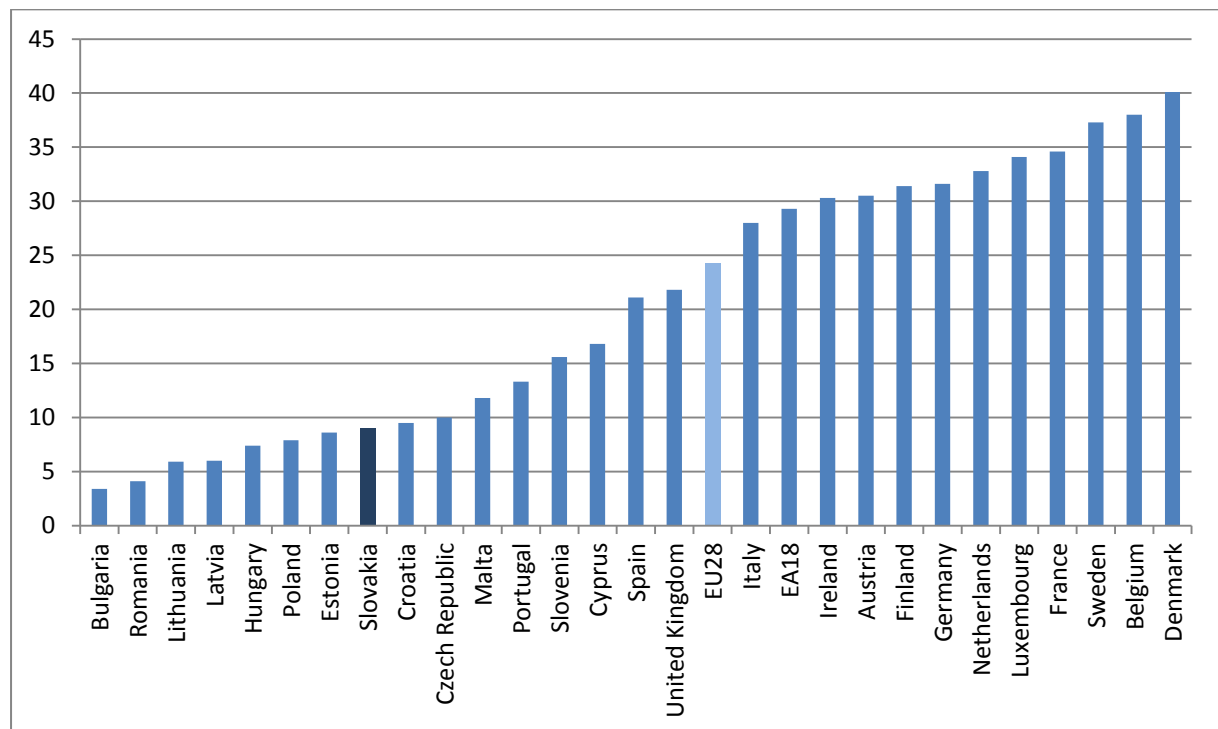
#### 4.2.4 Venture capital

Presence of venture capital is inevitable to build strong enterprises. Venture capital market in Slovakia is very small and backward. There are few funds that offer venture capital such as Slovak-American Entrepreneurs Fund (SAEF) and Slovak Venture Capital and Private Equity Association (SLOVCA) and also some private investors. Together with the development of entrepreneurial culture, also the venture capital market must be developed and it will be a long-term process. Government should step in the position of risk taker and guarantee the investments of investors to local venture capital funds or to starting Slovak businesses.

#### 4.3 Human capital

Human capital is one of the most valuable assets in knowledge based economy. As we have already mentioned, there are many foreign companies coming to Slovakia because of cheap skilled workforce (Figure 3).

**Figure 3: Hourly labour costs in the EU28 Member States in 2012 (in euro)**



Source: Eurostat, authors

However, the goal of Slovak universities should be to prepare knowledge students able to innovate and compete worldwide. Even though the number of students applicants to universities decreases each year (from 2007 till 2014 the number decreased from 85,000 to 60,000 per year), there is still 36 universities in Slovakia. Universities get subsidies from government according the number of students they have. The emphasis is on quantity, not on quality. The education system in Slovakia requires a huge reform. Here are some recommendations:

1. *Increase the reputation and salaries of teachers* - huge problem in education are low salaries for teachers, especially in primary and secondary education. Slovakia pays the least from the OECD countries to teachers in upper secondary education (OECD, 2014). Talented young people don't want to become teachers because of low life standard and not favorable reputation of teachers. Therefore this profession is chosen usually by the weaker and less-motivated students and the quality of education decreases. The government spending on education must increase and the salaries must gradually rise.

2. *Individual approach* – the studying system is based on general skills that must all students at primary and secondary school master. There is no space for activities pupils are more interested in or space for additional time for students who are weaker in some subjects. Therefore the system should take into account the individuality of each pupil and focus on subject the students enjoy. By the individual approach student can also improve their skills in subjects they are weaker at.

3. *Improve the content of education* – there are three parts of education – knowledge development, skills development and experimentation. Nowadays the schools system is mainly focused on knowledge development. However in the internet age the education should focus more on skills and experimentation development. The key knowledge for a person is how to access relevant information one need for a particular task and know how to use this information for solving complex problems. Therefore the content of education should be focus more on soft-skills as argumentation, critical thinking, presentations skills, critical reading, writing etc. It is also important to find innovative ways of involving the scientific and business community in education, so the students are in touch with practice.

4. *Universities reform* – the amount of students should decrease by relevant number, so the individual approach can be developed also at universities and only the best students will get on the universities. Nowadays there are many degree employers on positions where is no degree needed. These students are burden for public budget and don't bring desired added value for economy. Universities should be paid by the quality of education, not by quantity of students and students should pay some amount of tuition for education. If students must pay for their education, they will choose high quality universities. That will increase the competition between universities and increase the quality. Students should be given space to freely choose subjects they are interested in. That will increase the pressure on teachers to increase the quality of subjects otherwise they won't have any students.

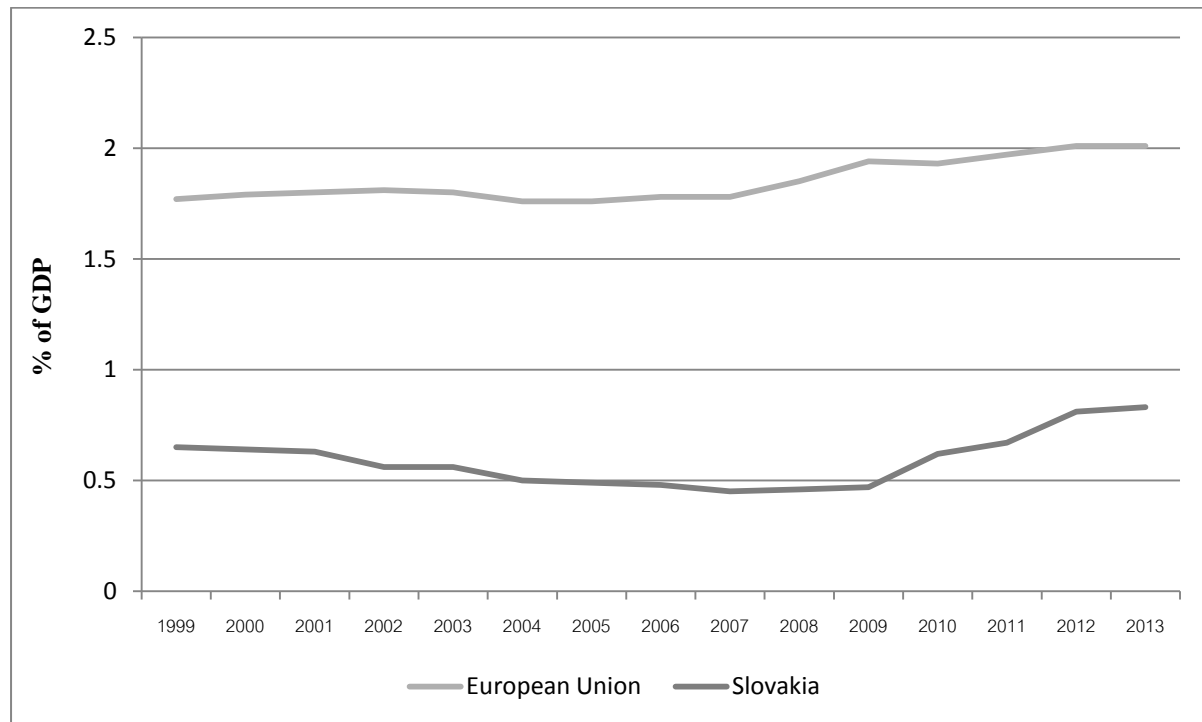
#### **4.4 Innovation support**

##### **4.4.1 Increase spending on R&D**

Investments are necessary in order to achieve better results in future. There cannot be any improvement without giving up today's consumption in order to bigger consumption in future. Investments, especially in R&D are inevitable for successful development of knowledge based economy. Slovakia spent only 0.83 % of GDP on R&D (Figure 4). Only Romania and Greece spend less from the EU countries. The R&D is therefore dependent on private spending. Research activities are not always successful and it takes a lot of time to test new ideas. Private companies invest in research only if there is high probability of return of investment. Professors and researchers are having hard time to finance their research if it is not directly connected to commercialization. From January 2015 government decided to indirectly support private R&D by entrepreneurs and firms, so they can use so called "super count out" on R&D costs and therefore decrease their taxes. However, Slovakia is still

missing direct support for academic or commercial R&D activities similar to Magnet Program in Israel. Government should start to gradually increase the spending to R&D and support successful Slovak researchers and innovators.

**Figure 4: Gross domestic expenditure on R&D in Slovakia and EU (% of GDP)**



Source: Eurostat, authors

#### 4.4.2 Knowledge infrastructure

Slovakia as a small country is dependent on international cooperation and partnerships. R&D is no longer driven by adaptation to local conditions but by a variety of new push-and-pull factors and involves complex stages of R&D. Therefore it is necessary for government to run several programs to ensure knowledge sharing and internationalization. To such programs belong international exchange of scientists and researchers, membership in research networks as ERA-MORE and others. Conferences focused on knowledge and innovation sharing for public and also private institutions to make interconnections is very important.

#### 4.4.3 Commercialization of R&D

Research without commercialization does not bring desired results. Therefore the government should ensure that the R&D is connected to firms and entrepreneurs that may be interested. One of the options is establishment of chief scientist on each ministry to encourage the commercialization of science and technology in their respective area of responsibility. These people should be responsible also for building the knowledge infrastructure.

#### **4.5 Fight against corruption**

None of the policies mentioned above will be successfully implemented if the country is heavily corrupted. Slovakia has big troubles with corruption and justice system. Establishment of special unit that will fight against corruption, will be independent and have power to act may be the first step in order to defeat corruption. Also strict punishments for responsible ones must be enforced.

#### **4.6 Interconnections**

Neither R&D, nor big investment can bring success to Slovak economy on its own. Probably the most important aspect of knowledge based economy is the interconnection. R&D alone will not bring such results as when it is connected to commercialization and when it its results are shared by more players. New starting businesses not only need finance capital, but also good mentors, venture capital, tax incentives, etc. Therefore the knowledge based economy policies should be implemented as a whole not as an individual approaches of each ministry. Public sector, private sector, nongovernmental sector, universities and research centers need to find way how to stay in touch and cooperate together. Very important are also connections to international markets, foreign investors and researchers. Slovakia should also use its unique location in the middle of Europe. Bratislava was the hosting place for the fifth top foreign and security conference in the world - Globsec. There are no doubts Bratislava couldn't host world's top conference about entrepreneurship, research and innovation. Bratislava should use its unique position near Vienna and Budapest and connect with these cities in research and business projects. There are many ways how to connect people from different areas. One of them is alumni groups of students of different universities, programs or field of interests. Especially the interconnection between different economy sectors and fields is important.

### **5. CONCLUSION**

Slovakia is a young post-communist country that made a huge progress in strengthening the market economy in the last 20 years. Slovakia is one of the fastest growing countries within the EU and has a big potential. Nowadays, the biggest challenge for Slovakia is to successfully move towards knowledge based economy. In the time of globalization, only the economies based on knowledge and innovations will enjoy growth and high quality of life standard. Therefore, it is inevitable for Slovakia to implement policies that support development of knowledge based economy and create such an environment that will boost the country's innovation and entrepreneurial potential. For a country to successfully move from industrial to knowledge-based economy is a long-term process that must affect every aspect of the economy. In this paper we have described the main knowledge based economy policies implemented in order to move towards knowledge based economy and we made recommendation for policies that could Slovakia implement.

First of all the role of government is very important in the process of moving towards knowledge based economy. The government should have the role of protector, risk taker and environment builder. It should invest substantial amount of money in R&D, development of human capital and set up pro-knowledge based economy policies. We have seen that the "top-down" approach can work very effectively if the government knows in what extend should be involved in the process and when it is time to leave the process for the market and

have just the controlling and supporting position. In the policies recommendation we see importance for Slovakia to focus on these main areas:

*Entrepreneurship support* – In order to strengthen entrepreneurship and formation of innovative businesses that are able to compete on international markets there are two main conditions that need to be fulfilled: supportive environment and accessible venture capital. Slovakia needs to moreover develop entrepreneurial culture and government should be strong supporter of Slovak entrepreneurs. Other policies in order to stop emigration of young people, stronger support for starting entrepreneurs and guarantees for investors should be developed.

*Development of human capital* – Good educational system with life-long learning opportunities is necessary for development of knowledge human capital. In education reform, it's necessary to boost the status of teachers and raise their salaries, so the profession is attractive for the best young people. The individual approach to students is very important in the education process. The education should focus on developing soft skills, critical thinking, argumentation and skills that are needed for entrepreneurs. Students should be learned to question everything, present their opinions and ideas. It is important during the studying years emphasize the importance of life-long learning and motivate students to reading and self-educating. It is necessary to interconnect students from different field of studies, build alumni groups where new connections can be made across different industries.

*Innovation performance* – There won't be any innovations without investing in R&D. Slovakia should invest substantial amount of money into research of public but also private institutions. Regarding to research, its commercialization is very important so the investment to R&D will be returned. Also in this case, the interconnection between universities and research centers, private companies and state is inevitable to achieve desirable results. Conferences and workshops where the new inventions can be shared are very important. Researchers must be in line with the international trends. Therefore the international exchange programs of researchers are very beneficial.

*Fight against corruption* – None of the policies mentioned above will be successfully implemented if the country is heavily corrupted. The law enforcement and high degree of justice must be ensured in country with knowledge based economy. Establishment of special unit that will fight the corruption and strict punishments for responsible ones may be good first steps. *Interconnections* – knowledge based economy is economy of information flowing and knowledge sharing. The process of exchange of knowledge must be ensured and different sectors of economy must learn how to cooperate together.

Some of the policies can be implemented right now and will bring very nice results in a short term. However, most of the policies require long-term approach and will bring the results after few years. Therefore Slovakia need to be patient, have a clear strategy and set the development of knowledge based economy as its priority.

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# **ROLE OF MANAGEMENT INFORMATION SYSTEMS IN THE INSTITUTIONS OF HIGHER EDUCATION**

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## **ABSTRACT**

Trends across the world show a growing demand for information systems for educational institutions. Many of them have been running manual systems, pushing paperwork, since ages. They have bulky working procedures and this leads to low productivity occasioned by manual systems. Many of the higher educational institutions (HEIs) have implemented one form of computer-based information system (CIS) or other to manage their academic and management needs.

There is a general demand on higher education institutional administrators to deliver high quality service; increasing need for management productivity; efficiency brought about by the systems. Recognition of information as an important corporate resource that is key to good decision making in a competitive and ever dynamic environment. Related technologies are now fairly priced and are therefore affordable to many institutions.

However, as the HEIs pursue for information systems implementation, they face a number of challenges to overcome which include lack of awareness and mindset among staff; lack of top level management commitment and red-tapism in implementation; lack of appreciation of ICT as a tool; poor strategy in making ICT responsive to the organizational vision and mission; lack of a systematic method of execution; inhibiting initial costs of hardware and software and funding for sustainability and continuity in maintenance, replacement of equipment and emolument of ICT staff who maintain the systems, among others. In this paper, an attempt to jot down and identify strategic management of organizations, strategic ICT planning, and integration of ICT in the management of higher educational institutions as key ways of overcoming some of the challenges that HEIs face in their effort to implement systems in the institutions.

**Keywords:** Management information system, higher educational institutions, increased efficiency, cost effectiveness, competitiveness.

# **ROLE OF MANAGEMENT INFORMATION SYSTEMS IN THE INSTITUTIONS OF HIGHER EDUCATION**

## **1. INTRODUCTION**

HEIs across the world are facing new challenges ranging from management, staffing, finances, and progressively more technology. Trends show that the rise of new stakeholders, internal factors, globalization and the rapid pace at which new knowledge is created and utilized provide major challenges to higher education institutions across the world.<sup>1</sup> Key challenges of higher educational institutions are the drop in research and publication by faculty due to acute teaching responsibility; poor leadership and management practices; poor remuneration of staff; diminishing financing; lack of quality standards to measure performance of the HEIs with their counterparts elsewhere; lack of jobs for graduates from the HEIs; gender inequality in favor of men; lack of further training opportunities; and lack of ICT capacity and utilization in the running of the institutions.<sup>1</sup>

ICT utilization in higher educational institutions has been key concern with many of the institutions having implemented various systems to help them manage information resources for better management of the institutions. The pace of ICT developments, their increasing availability, needed to tap the ICT potential to enhance data collection and analysis, and to strengthen management information systems in HEIs. This paper delve into the emerging trend of implementation of management information systems in HEIs; recognize the value of ICTs in HEIs management, strategies for implementation of the systems, challenges in the implementation, the way forward to successful implementation and management of the systems.

## **2. ROLE OF ICTs IN MANAGEMENT OF HIGHER EDUCATION INSTITUTIONS**

Information and communications technology has changed business organizations bringing out new ways of doing business that are innovative, efficient and more effective. Organizations today deal with new markets, new competition and increasing customer expectations hence the need to efficiently manage the information about competitors, their products, market trends, customer demands and technological developments.<sup>2</sup> Through the emergence of fast and powerful computers, networks and infrastructure, delivery of immediate and relevant information enables policymakers in an organization to make quick and accurate decisions.<sup>3</sup> According to Laudon ICTs provide tools for data collection, analysis, storage and dissemination to support decision making in organization.<sup>2</sup>

Environment of higher educational institutions are equally changing in the technology front. Acosta comments that Quick and accurate decisions of HEIs administrators require readily available and relevant information thus making ICT a vital tool in today's business world providing tools for information collection, storage, and management to facilitate communication and decision making processes.<sup>4</sup> He points out that HEIs too, must deal with the emerging trends of competing on the ICT platform, thus they need to continually assess their current status, and that of their competitors to formulate and manage their own strategies.

Brian Hawkins emphasized three propositions about the impact of ICT on higher education- the new technology affords exciting opportunities for more effective teaching, offers scalability that is greatly needed and will transform higher education beyond what we know it to be today.<sup>5</sup> Technology has provided exciting opportunities for teaching including the recent e-learning initiatives in addition to transforming HEIs operations. ICTs in higher educational institutions have come about from developments in corporate businesses where ICTs have been incorporated into organizational functions to improve their performance. The incorporation of ICT in organizational functions has been brought about by three main factors, viz. increased efficiency, cost effectiveness, and competitiveness.<sup>6</sup>

**Increased efficiency:** The efficiency brought about in institutions of higher education can be realized in areas of easy access to student and staff records, data on assets of the institutions as well as efficiency in processes like admissions and examinations.<sup>6</sup> Katz asserts that the ICT infrastructure is likely to influence and even shape the nature of higher education institutions and the practices of faculty and administrators. Faculty, parents, staff and students are demanding more information from the HEIs inform of grades, class registration, and contract administration thus expecting information systems of HEIs to operate automatically, integrated and accessible to users every time. HEIs are investing in systems that make it relatively easy and cost effective to acquire, store and manage volumes of information about institution's stakeholders.<sup>7</sup>

Some of the institutions of higher education in India implemented an academic management system to facilitate management of academic processes. The system has been designed to provide quick and easy access to management information. When fully operational, the academic management system will increase the productivity of staff involved in all academic departments. It will also improve the overall management of the institution.

**Cost effectiveness:** Hardware, software, telecommunications and related technologies are now fairly priced and therefore more affordable to many institutions. Wanyemi, points out that the strong interest in the adoption of ICT emerged in institutions of higher education's for three reasons. Among these three reasons one is that hardware and software-becoming cheaper, and therefore, more widely affordable.<sup>8</sup> Golola points out that the swiftness of ICT developments, their increasing spread and availability, the nature of their content and their reducing prices, are major implications for teaching and learning, research, libraries and information services, and university management.<sup>9</sup>

**Competitiveness:** Alter (2001) notes that organizations invest in information systems because they believe the systems will make a difference in the way the organization conducts its business- processes and functions, basically giving the enterprise competitive advantage. Academic institutions are not spared from competition and therefore need to make strategic moves, especially taking advantage of information technology. Institutions of higher education's have the challenge of ensuring that their processes are faster, less cumbersome and that the academic processes are designed in such a way to facilitate faster data collection and dissemination for management decision making.<sup>10</sup>

For Nyandiere information systems bring about faster and better decision making given the unlimited access to high quality and well maintained information resources. Management Information Systems get the HEIs to a level of elegance and pride, which can be seen, for example, through online access to records such as examination grades for students, access to learning material through an electronic learning environment.<sup>11</sup>

According to Acosta, institutions of higher learning, like all other businesses, need to continually assess their current status, and that of their competitors in order to come up with a plan, formulate and manage their own strategies if only to stay abreast with the latest challenges and intense competition posted unto them especially in the information age.<sup>4</sup> Wanyembi notes that colleges and universities, like other business organizations, have felt the pressure to invest in computer-based information systems to manage their business processes and more so manage the vast amounts of data they handle. Accordingly, information and communications technology (ICT) resources in colleges and universities continue to increase in numbers, value and sophistication as more and more institutions invest in new technology.<sup>8</sup>

HEIs are also turning to computer-based systems as tools to differentiate themselves in the education market place. Some of the HEIs are increasingly turning to ICT as a differentiating, and marketing tool, to provide quality services.

### **3. CATEGORIZATION OF HEI INFORMATION SYSTEMS**

Information management in HEIs, like many other institutions, is shaped by the demands of various entities that interact with the institutions both from within and from outside. Tusubira & Mulira indicate that in a university, the core business processes are learning and research, while finance and human resource management are support functions.<sup>6</sup> Information management within HEIs focuses on staff, students and resources management.<sup>11</sup> The information products include student details, that is, personal information of students; personnel information of staff which includes records of employees in various cadres; and academic details of courses on offer in various academic departments, curriculum, examination details, professors taking various courses, relevant books and journals and all relevant academic information necessary to enhance the core business of a university-teaching and research.

HEIs that have or are implementing computer-based systems take different strategies, but the most common is a combination of strategies. There are those that internally develop their applications. This assumes the institution has enough capacity- finances and staff to undertake computerization projects. The demerit for this is usually poorly developed and implemented systems. If institutions want to guarantee quality, many go for off-the-shelf packages while others contract specialist developers to implement the systems. Number of universities already has information systems handling students' data/ records, some based on open source systems, others granted by various agencies. Many of the systems donated by agencies are experiencing support problems especially after agencies left the scene perhaps due to lack of local expertise to continue with maintenance of the systems.<sup>12</sup>

### **4. CHALLENGES TO IMPLEMENTATION AND USE OF CISS**

Many of the HEIs face a number of challenges in their mission to implement information systems to manage processes in their institutions. According to Tusubira & Mulira following are the challenges of ICT incorporation in higher education institutions-

- Lack of awareness and mindset among staff leading to unqualified resistance and wanting to be stuck to the old ways of working.
- Lack of top level management commitment and red-tape in system implementation.
- Lack of appreciation of ICT as a tool.
- Poor strategy in making ICT responsive to the organizational vision and mission.
- Lack of a systematic method of system implementation
- Lack of involvement of all employees and users in system implementation.
- Inhibiting initial costs of hardware and software and funding for sustainability and continuity in maintenance.

There has been insufficient training and re-skilling of end users as well as technical staff that support the systems in HEIs. This is coupled with the inability of many institutions to recruit and retain qualified information systems staff.<sup>1</sup> For some institutions, technological complexity is a challenge with the real challenge being the security concerns for the data and the systems, especially where students have to access the institutional systems. Without proper controls, students can hack into the system and a change on examination grades, fees balance status or other modification can have serious ramifications on the institution.

System implementation is not just software project, but also an organizational change project. The projects call for co-operation, teamwork, and planning for organizational change and are difficult to do when senior management is too busy to give the project adequate attention. The projects bring about massive organizational changes as they consist of many functional modules that can span the whole organization and yet share a database.<sup>13</sup>

## **5. SUCCESSFUL IMPLEMENTATION & MANAGEMENT OF INFORMATION SYSTEMS IN HEIs**

From the challenges mentioned above, it come out that information systems and ICTs implementation in HEIs if not well handled can lead to heavy investment without resultant organizational benefits. HEIs should have mechanisms of implementing information systems by optimizing scarce resources- funds, skills and technology- to implement and sustain robust infrastructure that supports education and training. Successful implementation of systems for HEIs should focus on three key areas Strategic Management, ICT Strategic Planning, and ICT Integration in HEIs.<sup>6</sup>

**Strategic Management:** Strategic management of organizations implies a conscious and coordinated management of organizational activities, processes and resources for greater returns.<sup>2</sup> This requires strategic planning to develop long-term objectives for the entire organization and to specify strategies for acquisition of resources needed to accomplish objectives. The strategic planning establishes broad, long-term objectives of the firm and assesses the institution's current position relative to these objectives, considering opportunities and threats presented by the environment.<sup>14</sup> Strategic planning also outlines the organizational structure and total resources needed to implement the plan, and plans for the implementation process.

**ICT Strategic Planning:** To enhance strategic management, institutions of higher education do implement strategic information systems.<sup>3</sup> These systems, which are an outcome of information technology strategic planning, support institution's competitive strategy. ICT strategic planning, whose outcome is an ICT policy and master plan, makes ICT responsive to the organizational vision and mission, providing systematic methods of implementation through organizational ICT policies, and creating ownership of projects hence leading to sustainability and long term returns from ICTs.<sup>6</sup> A well-defined and owned ICT policy and master plan is a requirement to successful mobilization of funds, both internally and externally, for system implementation.<sup>11</sup>

**ICT Integration:** Today ICT is one of the most critical tools in higher education. ICTs navigate every aspect of the HEIs from the first contact a student has with its website and provide access to its information.<sup>4</sup> Integration of ICT in HEIs functions is a complex process which needs to be fully conceptualized and defined before implementation.<sup>6</sup> Tusubira & Mulira argue that there is need to quantify the requirements of the institution starting from number of students and staff, the extent of physical infrastructure, ICT resources and systems already in use. This sets the direction, functions and boundaries as well as targets of ICT in the institution, providing a framework for the development of specific projects aimed at increasing efficiency and cost effectiveness.<sup>6</sup> The ICT policy alluded to above should reassure employees, fearing job loss, by catering for training and retraining and opening up new opportunities for them. They need to recognize that they are part of the information system.

## 6. CONCLUSION

Looking forward to the future, many HEIs will automate and integrate most of their processes- they will be more paperless, more efficient, and competitive. Key stakeholders will be able to obtain all information from the set of systems implemented and accessible from institutions. Demand on institutions to give quality service is likely to continue growing for both public and private academic institutions. More and more institutions will see the need to invest in a good information management system, even primary and secondary schools. There is likely to be a collaborative approach, to the acquisition and implementation of the systems, especially to help mitigate costs. It is the author's opinion that costs are likely to continue in downward trend. The end result of investment on computer-based information systems in HEIs will be better management of these institutions as any other corporate business.

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**REFRAMING THE CONCEPT AND STRUCTURES OF THE CURRENT  
GOVERNANCE AND MANAGEMENT SYSTEM FOR GLOBAL DEVELOPMENT  
COOPERATION: THE CASE OF MDGs AGENDA**

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**ABSTRACT**

The purpose of this article is to examine the frame of MDGs from the perspective on global justice suggested by Nancy Fraser. MDGs somehow produced impressive achievements and, more importantly conveyed prospects for the global development. However, it is also clear that the agenda is incomplete and the main idea of the project needs a reframing. The new framework of the global development should be escaping from the donors, governments, elitism, and economism. It should be firmly based on the principles of global justice emphasizing the representation of the least-advantaged members in a globalizing world. It is argued that the framework of global development should be transformed to give them the first chance to voice and fight for their own goals and rights. All the channels and discussion tables should be open to them first without the excuse that they are incapable or less knowledgeable. The role of the states and NGOs are not to represent or lead them but to help them represent themselves until the global justice securely launched on this planet.



# **REFRAMING THE CONCEPT AND STRUCTURES OF THE CURRENT GOVERNANCE AND MANAGEMENT SYSTEM FOR GLOBAL DEVELOPMENT COOPERATION: THE CASE OF MDGs AGENDA**

## **1. INTRODUCTION**

In 2015, Millennium Development Goals (MDGs) have reached its promised land. Their Achievement was proudly announced, if not in an arrogant tone, and various future plans are pouring on the global development tables. However, polite and cautious celebration cannot avoid harsh realities and critical argumentations. Many seem to agree with two focal points; first, achievements can be recognized as a meaningful change, and second, we urgently need to have new paradigms and realistic strategies to fight against persisting, and even, worsening global problems and local miseries.

In this article, after achievements and discontents that MDGs have been making for the last 15 years are summarized, main arguments from significant supporters and critics will be briefly contrasted. Finally, conceptual issues in relation to MDGs and global development will be examined to suggest a new frame for more just and realistic development and global governance In the future. First of all, the results of MDGs will be discussed.

## **2. ACHIEVEMENTS OF MDGs**

The MDGs have been an influential framework for global development cooperation, not only in shaping the international discourse, but in driving the allocation of resources towards key global development priorities and improving policy monitoring. They have received unprecedented political commitment which reflects a strong consensus for tackling poverty eradication and other key priorities. Supporters of MDGs argue that the MDGs have proved to be a useful tool because their established time bound and concrete targets which galvanized political leaders, CSOs, the media and international organizations around a clearly defined agenda intended to improve human development.

UN Secretary General Ban Ki-moon proudly announced that the global mobilization behind the Millennium Development Goals has produced “the most successful anti-poverty movement in history” (United Nations, The Millennium Development Goals Report, 2015: p. 3).

According to him, the MDGs helped more than one billion people escape from extreme poverty and hunger and enabled more girls to attend school than ever before and to protect our planet. Especially, he emphasizes that MDGs generated new and innovative partnerships, galvanized public opinion, and reshaped decision-making in developed and developing countries alike (United Nations, The Millennium Development Goals Report, 2015: p. 3). His proud announcement seems to be well supported by the numbers and proportions which the final MDG report presents.

To take a few examples of ‘profound ‘achievements, it is quite impressive that some of the important goals have achieved in the past 20 years. Let’s take a look at poverty and

hunger, first. “Goal 1” which was aiming to eradicate extreme poverty and hunger made extreme poverty declined significantly. According to the report, nearly half of the population in the developing world lived on less than \$1.25 a day in 1990 and that proportion remarkably dropped to 14 per cent in 2015. Moreover, the number of people living in extreme poverty has declined by more than half, falling from 1.9 billion in 1990 to 836 million in 2015 (United Nations, 2015: p. 4).

Similarly, Goal 2 which was aiming to achieve universal primary education achieved 91 percent of the primary school net enrolment rate in the developing regions in 2015, up from 83 per cent in 2000 (United Nations, 2015: p. 4). We can find out similar impressive numbers and proportions in other goals related to gender, health, and environment.

However, we need to take a close look at Goal 8 which is concerned with “developing a global partnership for development to examine the achievements of this goal have been relevant and meaningful.

According to the report, official development assistance (ODA) from developed countries increased by 66 per cent in real terms between 2000 and 2014, reaching \$135.2 billion being indebted to strong and consistent support from major advanced countries like Denmark, Luxembourg, Norway, Sweden and the United Kingdom which had continued to exceed the United Nations official development assistance target of 0.7 per cent of gross national income (United Nations, 2015). However, it does not mean that the ODA has been efficiently and democratically used or this goal has really contributed an impressive “global partnership” for development. Moreover, the indices of average proportions in relation to export and import do not tell us much about actual economic situations in underdeveloped and developing countries.

Similarly, the fact that 95 per cent of the world’s population is covered by a mobile-cellular signal as of 2015 (United Nations, 2015) cannot be treated as a proof of the development of global partnership or empowerment of people who have been vulnerable and poor. Internet could be a new advantage and a knowledge channel for those people, but access to the new media does not guarantee a real improvement of economic and social conditions. Somehow, these limitations of numbers and indices were expected by many critics as early as MDGs were born. (Amin, 2006) At the final stage of MDGs now, many familiar criticisms including the quantitative indices still persist in spite of many impressive aspects of achievements.

### **3. CRITICISM ON MDGs**

Criticisms on MDGs generally do not seem to be saying that the achievements of MDGs are too little or all the efforts made were useless. Everyone knows that global problems cannot be easily solved and dramatic changes are still in our dreams. Therefore, evaluations of the achievements in their quantitative terms are not a severe issue of criticisms.

Even the leaders of MDGs in UN correctly point out the persisting problems in spite of the achievements. Immediately after proud statement, Secretary General Ban points out the problems unsolved as follows:

“Yet for all the remarkable gains, I am keenly aware that inequalities

persist and that progress has been uneven. The world's poor remain overwhelmingly concentrated in some parts of the world. In 2011, nearly 60 per cent of the world's one billion extremely poor people lived in just five countries. Too many women continue to die during pregnancy or from childbirth-related complications. Progress tends to bypass women and those who are lowest on the economic ladder or are disadvantaged because of their age, disability or ethnicity." (United Nations, 2015: p. 3)

Concluding his remarks, Secretary General Ban shows his confidence in solving those problems by unswerving political will, and collective, long-term effort. The way of solving problems seems to be clear, but the question is how? Moreover, when we look at the insufficient results of MDGs as appeared in the 2015 final report, we get to recall many criticisms which have been raised from the very beginning of the MDGs until now.

For example, the report shows that about 800 million people still live in extreme poverty and suffer from hunger and over 160 million children under age five have inadequate height for their age due to insufficient food while 16,000 children die each day before celebrating their fifth birthday, mostly from preventable causes. (United Nations, 2015: p. 8) Once again, main problem here is not the unsatisfactory achievements. Rather, the strong belief in main frameworks of MDGs could be a real problem for the global development in the future.

"The successes of the MDG agenda prove that global action works. It is **the only path to ensure that the new development agenda leaves no one behind.** ...At the core of this agenda is sustainable development, which must become a living reality for every person on the planet" (United Nations, 2015: p. 9).

Why is the MDG agenda the only path? How can we ensure that this framework will leave no one behind even though it has left many people behind already? Moreover, who decided that the core of future agenda will be sustainable development in spite of 800 million urgent people living in extreme poverty and suffer from hunger? All those questions have been ceaselessly raised in various criticisms, but mostly unanswered.

First, one of the most frequent and serious questions on the MDG agenda was its lack of consultations with all stakeholders. Even though the original 18 targets were selectively drawn from the text of the Millennium Declaration signed by 191 Heads of States, the MDGs agenda did not reflect all dimensions emphasized in the text of the Millennium Declaration.

Oya (2011) and Saith (2006) argue the World Bank had significant influence on setting the main indicator for poverty reduction as the proportion of people living below the poverty line of \$1 per day. The exclusiveness of the actors who led development of the MDGs is pointed out by Richard et al. (2011) who figures out that 'only 22% of the world's national parliaments formally discussed the MDGs'. Accordingly, there was very little participation or involvement of developing countries and civil society in the process of designing and setting MDG agenda (Kabeer, 2005; Waage et al., 2010).

The question on the formulation of the MDGs focusing on who identified the goals and targets, how and why certain goals were chosen and what political agendas influenced the structure of the MDGs is a serious criticism on the whole nature and the results of the agenda.

Therefore, this question is a fundamental challenge to the framework of whole MDG agenda as Amin has already argued in 2006 that driven by the triad ‘United States, Europe and Japan’, and co-sponsored by the World Bank, International Monetary Fund and Organization for Economic Co-operation and Development (OECD), MDG agenda was designed for neo-liberal globalization (Amin, 2006).

Many scholars add more critical points concerned with this question; absence of ‘a common, cross-sectorial vision of development’ which has resulted in fragmentation, incoherence and gaps in the existing framework (Waage et al. 2010), lack of national ownership for the goals because of making MDGs national priorities without the initial participation and consultation of developing countries (Fukuda-Parr, 2006; Haines & Cassels, 2004), and so on.

Second, the targets of MDGs which had been structured by the traditional development ideas focusing on economic growth and quantitative results induced the criticism that they ignore population dynamics, various social changes and deprivations, and qualitative aspects of development. For example, the target to reduce poverty by half and to cut child mortality by two-thirds could give us an impression that the achievements of those numbers have been reducing actual poverty and suffering by those levels despite the increase in the absolute number of people in poverty and various social sufferings and deprivations which were strongly concerned with poverty and mortality. (Vandemoortele, 2009)

In other words, this target of the poverty reduction ‘prioritizes material aspects of deprivation over non-material ones’ and leads to a reduced concept of poverty. (Maxwell, 2003) Targeting only 50% of the poor population is regarded by more critical scholars to be unethical and failing to be ‘forward looking.’ (Poku & Whitman, 2011; Saith, 2006)

More importantly, many scholars point out that only one of the seven key objectives of the United Nations Millennium Declaration (that of development and poverty eradication) specifically reflected to the MDG framework, whereas other goals such as peace, security, disarmament, human rights and democracy were left behind (Hill, Mansoor, & Claudio, 2010; Waage et al., 2010).

Therefore, MDGs cannot be free from the criticisms that they were inadequate and too narrow to bring more important changes in human development dimensions and human rights framework. For example, poverty is not just a matter of one dollar a day, but a matter of capability which is impossible to be achieved without human rights, security, qualitative and political aspects of social life. Similarly, MDG 3, which is targeted on the elimination of gender disparities in education, does not provide any remedies for social inequality and concrete plans to remove negative conditions to eliminate gender disparities.

Third, MDGs can be criticized for its simple and overtaking targets which did not carefully take into account that starting lines of the various regions and countries were all different. The fact that same targets were given to all different players at the same time shows us that the governance of MDGs agenda was initially top down. Consequently, the goals are quite ‘overambitious’ or ‘unrealistic’ since they largely ignore the limited local capacities, particularly missing governance capabilities (Mishra, 2004; Oya, 2011).

Fourth, and most seriously, the core value of the Millennium Declaration, equity and equality, has been insufficiently presented in the main stream of MDG agenda. For example,

Fukuda-Parr (2010) points out a missing goal for reducing inequality within and between countries. Others criticize that there is no focus on the 'poorest of the poor', masked by using national averages or aggregated information (Brikci & Holder, 2011). Therefore, few can deny that a 'tyranny of averages' where issues of inclusive and equitable progress are ignored because of average and overgeneralization within the framework of the MDGs has persisted. (Vandemoortele, 2010)

Consequently, the MDGs did not have a prospect for structural changes in globalization of capital and inequality. They were all about the results and outcomes which were not challenges or confrontations against structural forces continuously producing global problems such as environmental degradation, appropriation of natural resources, endless competitions of capital, and so on. Without a plan to suppress these negative aspects of globalization, how can we say that the project of MDGs is the only path to bring a new development to human beings on this planet?

Especially, it should be critically reviewed that the MDGs fail to include political and human rights. Ziai (2011) argues that MDG targets are presented not as political but as technical problems, where the solution appears as simply increasing financial resources. In this respect, much more serious problems like trade-offs and conflicts of interest in a globalizing world can be easily obscured

In this respect, it is not surprising that MDG agenda could not produce an impressive and sustainable global partnership even though it does not mean that there was no significant or broad support for an international development agenda. Many critics argue that it has not delivered on all the commitments it made to the global partnership for development. Important shortfalls, and even some setbacks, remain in delivering on aid commitments, establishing a fairer multilateral trading system, dealing comprehensively with the debt problems of developing countries, and providing affordable access to new technologies and essential medicines, as stipulated under MDG 8 as many UN reports point out. (United Nations, 2012: p. 10)

It is not a purpose of this paper to present a comprehensive list of all the criticisms made in the past 15 years. There are many other important issues and problems left behind after the MDGs. Moreover, MDG criticisms were mixed, sometimes disputed, and even confused. However, it seems to be clear enough from major criticisms that the limited focus on poverty, and not on reduction of inequity and inequalities, is a major omission of the MDG framework. In fact, along with progress, the issue of equity appears to be receiving increasing attention from the international community. The UN Task Team on the post-2015 UN Development Agenda has acknowledged that major points mentioned in the criticisms, such as inequalities, social exclusion, biodiversity, and reproductive health, are addressed insufficiently by the MDGs (UN Task Team, 2012). The task team also suggests human rights, equality and sustainability as core values of future goals.

In spite of sharp criticisms and self-reflective reports on many aspects of MDGs agenda, fundamental questions regarding the new paradigms for more equitable and just development are hardly found. Most of criticisms and new suggestions take it for granted that the nationalistic and state-centered approach with strong support from capital is a protagonist for the post 2015. Even though almost everybody is talking about cooperation and partnership among multi-stakeholders, the main stream of development discourses are focused on reform of United Nations, revised standards and targets, changes of emphatic

issues, and increased participation of individual nation-states. I believe this is the main problem for the post 2015 and the future of development and human beings in the world. As we have already seen, the poorest of the poor and even the poor in general have been treated almost like global beggars or immature children in spite of the emphasis on education and empowerment. Consequently, they were not treated as the most important social groups and hardly represented in the process of conception and execution of MDGs agenda. However, development should be socially meaning and globally just in this globalizing world, as Robinson suggests the importance of social process and re-conception of development not in terms of nations but in terms of social groups in transnational setting. (Robinson, 2002: p. 1062)

Furthermore, McMichael asserts that the development paradigm as well as global project has not been free from not only exclusion the people but from various inequalities and power relations;

“The globalization project has been a relatively coherent perspective and has had a powerful set of states, agencies, and corporations working on its behalf. Nevertheless, its discourse and rules are always in contention because this project is realized through various inequalities. Like the development project, the globalization project is an attempt to fashion the world around a central principle through powerful political and financial institutions. Since the principle is framed as a discourse of rights and freedom, its power ultimately depends on the interpretation and effect of these ideas (McMichael, 2004: p. 238).

Under the circumstances that most governments feel the pressure to play by the new and emerging global rules and global restructuring weakens nation-states by eroding their public welfare function, increasing social and regional polarization, and reducing state patronage systems, the frame of current development approaches which have shaped MDGs agenda should be reformed to make it possible that global citizens, especially the most vulnerable and poor can have fresh opportunities to renew the political process of globalization and development agenda (McMichael, 2004: p. 239).

In this respect, the revolutionary transition from neo-liberal and status quo developmentalism to a new powerful governance system for global development and human rights in their full meanings should be framed and achieved by the people. In the next section, a theoretical implication for reframing the global development cooperation will be discussed by adopting Nancy Fraser’s discourse on global justice.

#### **4. REFRAMING THE GLOBAL DEVELOPMENT COOPERATION**

It is beyond the scope of this paper to discuss whole theoretical arguments suggested by Nancy Fraser. Here, her main ideas concerned with the reframing of global development paradigm on the basis of global justice theory are presented and some necessary steps and strategies to realize the reframing will be suggested.

In *Reframing Justice in a Globalizing World* (Fraser, 2005), Fraser criticizes “Westphalian” frame for international relations and theories of justice which has been

seriously disregarding the political dimension of representation, and accordingly, suppressing our scope for justice and equality in a globalizing world which requires a new frame incorporating three dimensions of justice, namely, distribution, recognition, and representation which is encompassing three levels (Fraser, 2005: p. 5);

In this essay, I shall propose a strategy for thinking about the problem of the frame. I shall argue, first, that theories of justice must become three-dimensional, incorporating the political dimension of *representation*, alongside the economic dimension of distribution and the cultural dimension of recognition. I shall also argue that the political dimension of representation should itself be understood as encompassing three levels. The combined effect of these two arguments will be to make visible a third question, beyond those of the ‘what’ and the ‘who’, which I shall call the question of the ‘how’. That question, in turn, inaugurates a paradigm shift: what the Keynesian-Westphalian frame cast as the theory of social justice must now become a theory of *post-Westphalian democratic justice* (p. 5).

Post Westphalian democratic justice can be characterized by an emerging sense of the globalization of many problems and conflicts as well as by new and confronting forms of governance. According to Fraser, the question of who is and should be re-implicated when reasoning about justice and means of redressing injustice, because the nation-state cannot be the answer to the question any longer. “Who question” is not only about effectiveness and possibility of realizing global justice and development, but, more importantly, about the central subject of justice itself. Fraser asserts that we need new concept of framing and of representation which needs and a new political ground. In other words, the issue of distributive justice and recognition in the theory of justice cannot be adequately addressed within a framework of an individual nation-state or in a certain society and more importantly, any justice theory without a primary and concrete consideration of who should be represented in what way would lead us to injustice which is destroying the fundamental principle of justice, equality for all.

According to Fraser, “Misrepresentation occurs when political boundaries and/or decision rules function to deny some people, wrongly, the possibility of participating on a par with others in social interaction—including, but not only, in political arenas (Fraser, 2005: p. 7-8). Therefore, the issue of representation, the third dimension of justice, takes a key role in Fraser’s theory of global justice and misrepresentation inevitably causes injustice.

Fraser distinguishes two types of misrepresentation. The first one is Westphalian type of ordinary political misrepresentation” which refer to political decision rules that deny full political participation to some individuals or groups within a given frame. The second type of misinterpretation, which became widely visible with globalization, is “misframing” and refers to the boundary setting aspect of the political which wrongly entirely exclude some people from the chance to participate, as Fraser argues;

“...a second level of misrepresentation, which concerns the boundary-setting aspect of the political. Here the injustice arises when the community’s boundaries are drawn in such a way as to wrongly exclude some people from the chance to participate *at all* in

its authorized contests over justice. In such cases, misrepresentation takes a deeper form, which I shall call *misframing*. ...Constituting both members and non-members in a single stroke, this decision effectively excludes the latter from the universe of those entitled to consideration within the community in matters of distribution, recognition, and ordinary-political representation. The result can be a serious injustice. ...Still more serious, of course, is the case in which one is excluded from membership in any political community. Akin to the loss of what Hannah Arendt called 'the right to have rights', that sort of misframing is a kind of 'political death. Those who suffer it may become objects of charity or benevolence. But deprived of the possibility of authoring first order claims, they become non-persons with respect to justice (Fraser, 2005: p. 8-9).

These two types of misrepresentation can be the most serious criticism for MDGs agenda. As I pointed out in the last section, lack of representation of the poorest and the poor, unequal participation of less developed countries, and state-centered path toward development and globalization are strongly related to the issue of misinterpretations. Especially, those who are suffering from absolute poverty and hunger have been treated as the objects of charity or benevolence. It does not mean that MDGs agenda and even its critics do not care the human issues of the poorest and vulnerable. The main argument here is that the process of development project and globalization in which those people cannot have a chance to take any significant role itself is the most serious injustice. In addition to well-known inequality and disparities in individual nations and societies, most of global governance systems in relation to development and international aids have not taken any serious account of this type of injustice from misframing. As long as our conception of development and global cooperation for human rights are captured by Westphalian frame and structural and conceptual ignorance of the poor as the right-holders and subjects of global justice, global problems and injustice will continuously march together and current power-holders will be getting more powerful driving whole planet to global misery and sufferings. This is more obvious if the state continues to take a role of confining political representation within the boundary of the nation and subordinating people's rights to the power and capital, as Fraser criticizes (Fraser, 2005: p. 9).

Increasingly subject to contestation, the Keynesian-Westphalian frame is now considered by many to be a major vehicle of injustice, as it partitions political space in ways that block many who are poor and despised from challenging the forces that oppress them. Channeling their claims into the domestic political spaces of relatively powerless, if not wholly failed, states, this frame insulates offshore powers from critique and control. Among those shielded from the reach of justice are more powerful predator states and transnational private powers, including foreign investors and creditors, international currency speculators, and transnational corporations. Also protected are the governance structures of the global economy, which set exploitative terms of interaction and then exempt them from democratic control.

Therefore, any discussions and prospect for the post MDGs must be restarted from tackling these misrepresentation problems and redesigning the development cooperation on



the basis of reframed theory of global justice. More than ever before, we need a theoretical ground to make people, especially the poorest and most vulnerable at the center of the development agenda as the first and final decision maker and plaintiff for historical exploitation and current global problems which have been mostly made by so called “donor” countries and capitalists. Here, we may need to recall Rawls’ principle of justice (Rawls, 1971: p. 302);

- “(a) they are to be of the greatest benefit to the least-advantaged members of society, consistent with the just savings principle (the difference principle).
- (b) offices and positions must be open to everyone under conditions of fair equality of opportunity.”

However, reframing and refining an appropriate theoretical ground takes time to debate and make a consensus. We need to start to immediately discuss this issue and disseminate the necessity of transforming the frameworks of development and globalization by mobilizing any means and resources. Especially, social movement actors and development NGOs have to recognize this fundamental ground for global justice and cooperate to produce plausible strategies to bring back the least-advantaged members of global society in the core of the development agenda.

It is beyond my ability to clearly suggest some of effective strategies for this transformation. However, I would like to suggest a couple of directions for procedural changes to give the poorest and vulnerable chances to speak out and participate directly at the table of important debates on human rights and global development.

First, social movement activists and international NGOs have to make their own regular system to invite those people in their activities and managements by using every possible means of communications and education. Here, most important thing to be considered first is their direct participation and priority. After getting knowledge and experience of this new governance system, they should bring this system to major global governance systems such as United Nations, World Bank, World Economic Forum, World Social Forum, and so on. There must be strong resistances and all kind of excuses that undermine the capabilities of the people against the adaptation of priority of those people in their systems. Even though it will be definitely a most difficult challenge for global civil society, those organizations and political spaces are right battle grounds for right battles to win the global justice and planetary peace.

Second, global civil society has to concentrate their energy on running capitalists and money players who have been responsible for global financial crisis and ecological disasters to earth. This is the matter of distributive and, more importantly, retributive justice. Any development agenda should include goals to get rid of injustice makers.

All in all, limitations and unsatisfactory achievements of MDGs clearly show that developmentalism based on power plays among strong nations and capitalists could not make a meaningful change and we urgently need to make a new development paradigm by reframing the global justice theory and direct initiatives by the people under global grievances.

## 5. CONCLUSION

MDGs somehow produced impressive achievements and, more importantly conveyed prospects for the global development. However, it is also clear that the agenda is incomplete and the main idea of the project needs a reframing. The new framework of the global development should be escaping from the donors, governments, elitism, and economism. It should be firmly based on the principles of global justice emphasizing the representation of the least-advantaged members in a globalizing world. Definitely, it is not just a matter of “principles of justice” as Rawls suggested, but a matter of direct and practical seize of power by the starving and suffering people. Therefore, the framework of global development should be transformed to give them the first chance to voice and fight for their own goals and rights. All the channels and discussion tables should be open to them first without the excuse that they are incapable or less knowledgeable. The role of the states and NGOs are not to represent or lead them but to help them represent themselves until the global justice securely launched on this planet.

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## **UNDERSTANDING CUSTOMER CO-CREATION : GROUPING, CHARACTERISTIC AND IMPLICATION**

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### **ABSTRACT**

**Background.** Co - creation have been conceptualized as typological by some researchers to show its variations and existing activities. Co - creation activities is customer's involvement or participation in creating value through interaction with provider. It's needed to enhance customer co-creation in order to increase customer value, not only for functional value, but also for relational, enjoyment and learning value.

**Objectives.** This study aims to determine the grouping of customers based on their co-creation activities and to identify characteristics of the groups. By understanding of the groups, it would be identified the way to enhance customer co-creation activities.

**Design/methodology/approach.** The study is using higher education services as the study context. It involved students of master degree programs at eighteen universities in Indonesia. The sample selection is done by a multi-stage sampling, in which the numbers of sample were 255 students from nine private universities and 253 students from nine public universities. Statistical methods used in this study were factor analysis and cluster analysis.

**Findings.** There are five factors underlining the student' co-creator activities; i.e. information finding, responsible behavior, feedback, helping and tolerance. The other finding is there are three groups of students based on their co-creation activities; they are higher, irregular and lower co-creator. Furthermore, the percentage of higher co-creator in private university is considerably higher than in public university, but the percentage of irregular co-creator is slightly lower in private university.

**Implications.** The study is expected to contribute to the way of how to enhance participation and citizenship behavior of students. It is expected to provide guidance for higher education practitioners in order to manage the student co-creation in order not only for university interest but also for their students. Also, it is expected to give inspiration to other service context in order to segment of their customer based on co-creation activities.

Keywords: customer co-creation, participation, customer citizenship behavior, higher education marketing, S-D Logic, segmentation, Indonesia.

# **UNDERSTANDING CUSTOMER CO-CREATION : GROUPING, CHARACTERISTIC AND IMPLICATION**

## **1. INTRODUCTION**

In historical perspective, terminology of value can be classified into two meanings, namely value as a “goodness” determined by an individual personally, culturally and an ethical sense, and value as as ‘goodness’ but in its description of something, be it a person, an idea, a product, an activity or anything else physically external to the person (Ng & Smith 2012). Also, value is consumer’s benefits, which is made by company and distributed to market, which is usually through exchange of goods and money (Vargo, Maglio & Akaka 2008). Marketing contribution perspective to value has shifted to the present, in which the contribution of marketing began as creator of utility and value-adding, and then marketing contribution as an orientation to customers and deliver value, up to contribution of marketing as a union of stakeholders and value co-creation (Lusch & Webster, 2011).

In delivering value, co-creation has received attention from scholar and researcher. The initial concept of co-creation is a creation of values shared by companies and customers, which enables customers to construct experience, define and solve problems together, creating an environment of experience where customers can actively engage in dialogue (Prahalad & Ramesway, 2004). Furthermore, co-creations become a growing and dynamic concept, where in marketing literature, co-creations conceptualized in two perspectives, namely in perspective that focuses on company and customer (McColl-Kennedy et. al 2012). In perspective of focusing on company, co-creations are seen as part of company's activities in managing their customer's involvement in creation of value, regarded as outsiders in creation of value.

Even though researches on co-creation have developed in many perspectives, there is few studies elaborating co-creation activities as the basis of customer grouping or segmentation. In order to customize their offering, marketer need to understand how the variations of customers in perform co-creation activities. Such variations are reflected on how grouping of customers, what the characteristics of each groups and what strategies to enhance and develop customer co-creation activities on each group. Based on the background, this study elaborated how co-creation activities can be a basis for segmenting customer. The study used higher education services as context of study. In particular, the objectives of this paper are as follows: 1) to describe what factors underline co-creation activities; 2) to group of students based on their co-creation activities; 3) to identify characteristics of the group; and 4) to identify marketing implications based on the characteristics.

## **2. LITERATURE REVIEW**

### **2.1. Customer Value Co-creation**

Co-creation has been conceptualized as typological by some researchers, to show the varieties and activities in co-creation. Co-creation activities typology can be traced from Yi and Gong (2013). It describes the behavior of co-creation in two dimensions, namely participation and extra role behavior. Participation consists of information finding,

information sharing, responsible behavior and personal interactions, while the extra role behavior comprise of feedback, advocacy, helping, and tolerance. In new products development, type of co-creation can be grouped based on contribution and selection activity (O'Hern & Rindfleisch, 2009). Contribution activities are the extent of contribution opportunity to value creation whether customers are empowered (open) or controlled (fixed), and the selection activity is whether selection carried out by company or customer. Activity types from this co-creation are submitting, tinkering, co-designing and collaborating.

Another typology is co-creation associated with co-production, in which there is a matrix of co-production - co-creation by looking at the kind of engagement or dialogue and creation of key values (Chathoth et al., 2013). Involvement or dialogue can be sporadic or continuous, and the creation of key value can be on production process as well as on consumption or use. This typology resulting four approaches namely co-production, firm-driven service innovation, customer-driven customization, and co-creation. Also, co-creation on medical services can be classified by the level of activity (high vs. low) and the amount of interaction with other individuals (high vs. low) (McColl-Kennedy et al., 2012), which resulted five typology of activities, namely adapting pragmatically, team management, insular controlling, passive compliance and partnering. In five activity types, co-creation activities can be grouped into eight activities (8 c), including cooperating, collating information, combining complementary therapies, co-learning, changing ways of doing things, connecting, co-producing, and cerebral activities.

## **2.2. University Segmentation**

Study of higher education students as customers in marketing literature has received attentions from scholars in some perspectives. For instance, study of students related with satisfaction found that introducing students to social and academic life of the campus, as well as building a relationship with an instructor and freshman class community, increases their satisfaction (Schee, 2011). Other study also conform other factors as antecedent of student satisfaction, such as: school placements and atmosphere among students (Gruber et.al 2010); campus student housing facilities (Najib et al., 2011); faculty, advisory staff and classes (Hameed & Amjad, 2011); responsiveness, communication and access (Douglas et al., 2008); and quality of teaching and non-teaching services (Petruzzellis, 2006).

Student as customer also have attention from perspective of segmentation issue, for instance how their characteristic and how to serve their need and wants. There are three group of student based on the benefit sough in higher education, they are learning resource quality seeker group, learning environment seeker group, and lecturing seeker group (Sutarso & Suminar, 2010). In the context of major factors students emphasized when selecting a school or department, the students were categorized into three groups, namely “career oriented” students, “emotion oriented” students, and “environment oriented” students (Chen & Hsiao, 2009). Student also classified in two cluster based on student food shopping behavior (Ness, Gorton, & Kuznesof, 2002). Cluster one is typical of students who are relatively less responsible for their funding and are less cash constrained, as well as cluster two is typical of the majority of the student body who are relatively more cash-constrained and more responsible for their own funding.

### 3. METHODOLOGY

#### 3.1. Data Collection

The data in this study were collected from survey gathered by an independent questionnaire. The questionnaire was designed to determine the relative agreement of factors represent co-creation activities. The questions were developed by reviewing relevant literature and a preliminary interview; in which these questions represent co-creation activities. The items are adopted from Yi and Gong (2013). A pre-test of the questionnaire was conducted mainly in order to examine and modify the questionnaire with regard to its wording, comprehensiveness, and easiness. The measurement of individual items was based on the Likert scale expressing student's attitudinal evaluation of items, in which seven answer categories, 1- 7, were used for the questionnaire, from "strongly disagree" (1) to "strongly agree" (7). Higher score value indicates higher level of student co-creation activities.

#### 3.2. Population and Sample

The population of the study is graduate students in the master of management program (Master of Business Administration / MBA), which the program obtained A level accreditation from National Accreditation Board for Higher Education, Indonesia. There are 18 universities from 10 cities in Indonesia participating in the study. The analysis unit in study is indicating the entity used in analysis (Trochim and Donnelly 2008), which can be either individual or group. In this study, the unit of analysis is individual or student. Sampling technique used is two-stage sampling, i.e. in the first stage of sampling is at study program level using probability sampling and the next stage is at respondent or individual level using judgement sampling. The study distributes 890 questioners, it was returned 590 questioners, and could be analyzed 508 questioners. Sample description of the study is illustrated on Table 1.

**Table 1: Description of Respondents**

Aspect	Classification	Public University		Private University		All University	
		Number	Percent	Number	Percent	Number	Percent
Gender	Male	141	55.3	115	45.5	256	50.4
	Female	114	44.7	138	54.5	252	49.6
Semester	2	44	17.3	123	48.6	167	32.9
	3	166	65.1	96	37.9	262	51.6
	4	36	14.1	33	13.0	69	13.6
	5	5	2	1	0.4	6	1.2
	≥ 6	4	1.6	0	0	4	0.8
Age	<30 year	150	58.8	152	60.1	302	59.4
	30 - 40 year	50	19.6	65	25.7	115	22.6
	41 -50 year	18	7.1	14	5.5	32	6.3
	> 50 year	3	1.2	1	0.4	4	0.8
Occupation	Abstain	34	13.3	21	8.3	56	10.8
	Not yet working	50	19.6	77	30.4	127	25.0
	Entrepreneur	34	13.3	35	13.8	69	13.6
	Professional	133	52.2	94	37.2	227	44.7
	Service Servant	29	11.4	45	17.8	74	14.6
	Abstain	9	3.5	2	0.8	11	2.2



Aspect	Classification	Public University		Private University		All University	
		Number	Percent	Number	Percent	Number	Percent
Percentage of tuition fee paid by own students.	0 -25 %	72	28.2	112	44.3	184	36.2
	26 -75 %	33	12.9	37	14.6	70	13.8
	76 -100 %	137	53.7	103	40.7	240	47.2
	Abstain	13	5.1	1	0.4	14	2.8
	Total	255	100	253	100	508	100

Based on the table above, the respondents of this study is totally aqual between male (50.4 %) and female (49.6%), more than half is on the 3rd semester (51.6 %), the majority is under the age of 30 years (59.4%). In terms of occupation, mostly are professionals (44.7%), and those who pay themselves or most of the costs on their own responsibility is the greatest proportions (47.2%).

## 4. DATA ANALYSIS

### 4.1 Factor analysis

Factor analysis is method of simplifying complex and interrelated observation variables into common factors, or a horizontal grouping of data obtained in a study. Stages of data processing of factor analysis in this study are as follows: preparation of raw data matrix, correlation matrix preparation, factors extraction, weighting factors, and varimax rotation. The feasibility of factor analysis was performed on the data before conducting factor analysis. On the adequacy of inter correlation between data or testing the existence of correlations between items, the study found more than 60 percent correlation between items through Pearson correlation. It means there are a quite number of correlations between items. Testing through Bartlett test of sphericity test show that factor analysis could be obtained (approx. chi-square = 589.355,  $p = 0.000$ ). Meanwhile, measure of sampling adequacy (MSA) demonstrates the value of more than 0.5 or has met the cut of value (Hair et.al, 2010). Thus, the data meets the requirements, so the factor analysis can be carried out.

The factor analysis on co-creation activities variables produced five factors, reflected in Table 2. Based on the items in the factors, it can be given a factor name as a in the table, including feedback (three items), helping (three items), tolerance (three items), responsible behavior (five items), and information finding (five items). The analysis revealed the factors, with the total variance explained 71 percent, factor loading on each factor ranged from 0.549 (I am looking for information about the course materials from various sources) until 0.908 (I help other students who have problems in understanding course material).

**Table 2: Co-creation Activities Factors**

Factors	Items	Factor Loading
Feedback	If I have an idea on material taught, I let the lecturer know	0.835
	When the lecture give an explanation that appeals to me, I comment about it	0.734
	When I have a problem in receiving an explanation in class, I inform to the lecturer	0.785
Helping	I assist other students who have difficulty in completing coursework	0.863
	I help other students who have problems in understanding course material	0.908
	I teach other students how to understand the course material	0.832
Tolerance	If the time of rescheduled class is not convenience with me, I would be willing to understand with it	0.784
	If a lecturer take action that I think it is not appropriate, I would be willing to be patient	0.804
	If the lecture was postponed, I would be willing to adapt.	0.833
Responsible Behavior	I performed all coursework given by the lecturer	0.691
	I adequately completed a minimum number of class attendance	0.588
	I followed the lecturer direction in how to do learning	0.699
	When the lecturer explains, I listen carefully	0.746
	When I meet a lecturer, I'm greeting	0.747
Information Finding	If there is information about course works that I do not know, I ask to the lecturer.	0.596
	I look for information about the course materials from various sources.	0.549
	In the conversations of class schedule replacement, I inform when the time I can.	0.606
	I inform the lecturer about my assignment	0.799
	I inform difficulty on understanding a course to assist the lecturer in teaching	0.712

#### 4.2 Cluster analysis

Cluster analysis was used to classify subjects based on number of variables in order to establish groups; hence the objects united in one group would be as similar as possible and the differences between groups would be as far as possible (Hair et. al, 2010). Cluster analysis procedure consists of five steps, namely preparation of the raw data matrix, the design of research in cluster analysis, hierarchical calculation procedure, the calculation of K-means cluster, and the formation of cluster profiles. Estimation was done by hierarchical procedure to find how many clusters to be created, while K-mean cluster specified number of clusters in which clusters were selected. The results of cluster analysis using SPSS 16 software and conducted by k-means cluster -shown by the cluster center (cc) - describe the score on Table 3 and Graphic on Figure 1.

**Table 2: Cluster Center of Co-creation Groups**

Factors	Groups (Percentage)		
	Higher Co-creator (53%)	Irregular Co-creator (29%)	Lower Co-creator (19%)
Feedback	0.322	-0.151	-0.677
Helping	0.575	-0.849	-0.328
Tolerance	0.145	0.332	-0.915
Information Finding	0.268	0.360	-1.306
Responsible Behavior	0.639	-0.979	-0.308

**Figure 1: Characteristic of Co-creation Groups**

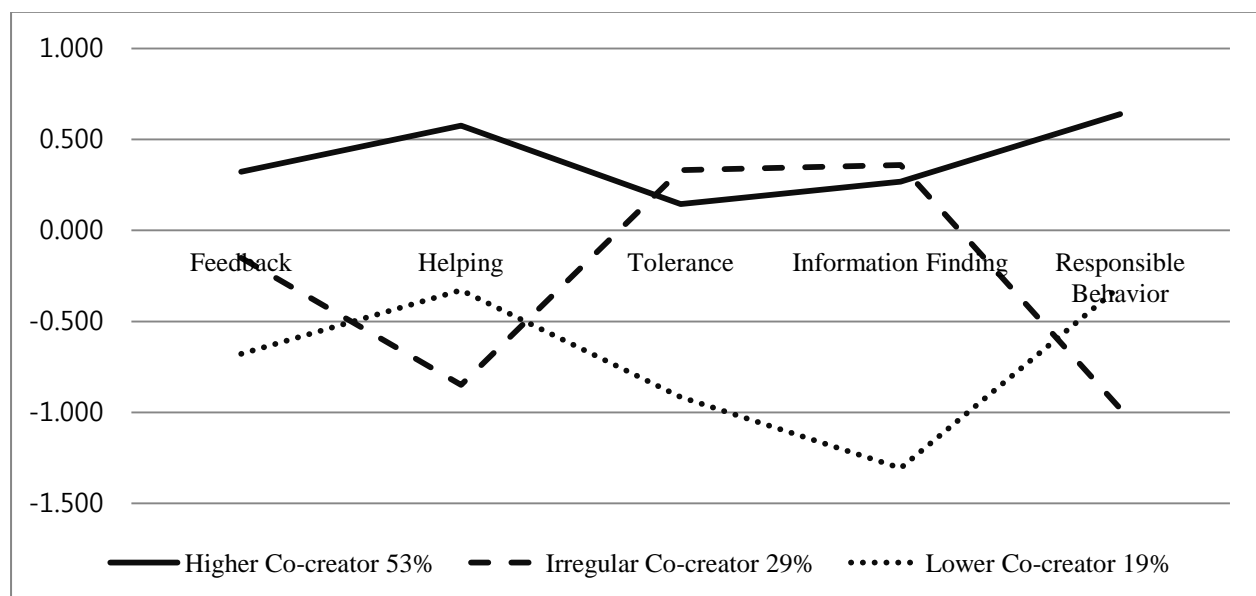


Figure 1 describes the characteristics of co-creation activities group indicated by the score of cluster center (cc). Higher score shows higher level of particular characteristics of the group. This study found three student group or clusters based on co-creation activities (Figure 1), in which the first group is illustrated by solid line, the second group is showed by the dash line, and the third group is described by dot line.

Based on the characteristics, the first group, called as *higher co-creator*, has highest cluster center on feedback (0.322), helping (0.575) and responsible behavior (0.639). The group has moderate cluster center on tolerance (0.145) and on information finding (0.268). The second group, called *irregular co-creator*, has the highest cluster center on tolerance (0.332) and information finding (0.360), in contrast it has moderate cluster center on feedback (-0.151) and the lowest cluster center on helping (-0.849) and responsible behavior (-0.979). The last group, called *lower co-creator*, has the lowest cluster center on feedback (-0.677), tolerance (-0.915), and information finding (-1.306) and moderate cluster center on helping (-0.328) and responsible behavior (-0.308). Thus, the higher group has three highest and no lowest cluster center, in contrast the lower group has no highest and three lowest cluster centers.

**Table 4: Demographic Characteristic of Groups**

Aspect	Classification	Group					
		Higher Co-creator		Irregular Co-creator		Lower Co-creator	
		Number	%	Number	%	Number	%
University Type	Private	152	<b>56.7</b>	57	39.3	46	48.4
	Public	116	43.3	88	<b>60.7</b>	49	<b>51.6</b>
Gender	Male	141	<b>52.6</b>	60	41.4	55	<b>57.9</b>
	Female	127	47.4	85	<b>58.6</b>	40	42.1
Semester	2	72	26.9	52	35.9	43	<b>45.3</b>
	3	145	<b>54.1</b>	75	<b>51.7</b>	42	44.2
	4	44	16.4	16	11.0	9	9.5
	≥ 5	7	2.6	2	1.4	1	1.1
Age	<30 year	141	<b>53.0</b>	97	<b>66.9</b>	63	<b>66.3</b>
	30 - 40 year	68	25.4	28	19.3	19	20.0
	41 -50 year	24	9.0	3	2.1	5	5.3
	> 50 year	3	1.1	1	1	0	0
	Abstain	31	11.6	16	11.0	8	8.4
Occupation	Not yet working	62	23.1	47	32.4	18	18.9
	Entrepreneur	35	13.1	21	14.5	13	13.7
	Professional	117	<b>43.7</b>	60	<b>41.4</b>	50	<b>52.6</b>
	Service Servant	46	17.2	15	10.3	13	13.7
	Abstain	8	2.0	2	2	1	1.1
Percentage of tuition fee paid by own students.	0 -25 %	80	29.9	71	<b>49.0</b>	33	34.7
	26 -75 %	36	13.4	18	12.4	16	16.8
	76 -100 %	142	<b>53.0</b>	54	37.2	44	<b>46.3</b>
	Abstain	10	3.7	2	1.4	2	2.1
Total		255	100	253	100	508	100

The demographic profile of student groups can be described as in Table 3. The table illustrates the important findings describing the proportion of demographic aspect in the groups. The proportion of *higher co-creation group* is dominated by student from private university (56.7%), male (52.6%), at semester 3 (54.1%), age < 30 year (53%), work as professional (43.7%) and percentage of tuition fee paid by own students on 76-100 percent (53%). Whereas the proportion in *irregular co-creation group* is dominated by student from public university (60.7%), female (58.6%), at semester 3 (51.7%), age < 30 year (66.9%), work as professional (41.4%) and percentage of tuition fee paid by own students on 76-100 percent (37.2%). And, the proportion in *lower co-creation group* is dominated by student from public university (51.6%), male (57.9%), at semester 3 (45.3%), age < 30 year (66.3%), work as professional (52.6%) and percentage of tuition fee paid by own students on 76-100 percent (46.32%). Thus, the proportion of groups is difference only on university type, gender and semester aspect. The percentage of higher co-creator in private university is considerably higher than in public university, but the percentage of irregular co-creator is slightly lower in private university. By discriminant analysis, the study found that the variable of university type ( $F=5.875$ ;  $p = 0.003$ ), gender ( $F=3.722$ ;  $p = 0.025$ ), semester ( $F=6.470$ ;  $p=0.002$ ), occupation ( $F=3.105$ ;  $p=0.046$ ) and percentage of tuition fee paid by own students ( $F=5.585$ ;  $p=0.004$ ) were difference among the groups.

## 5. DISCUSSION

Based on the results of statistical analysis, there are three important issues needed to be addressed. *Firstly*, the issue related to what factor representing co-creation activities of students. In this issue, it is elaborated the factors shaping the co-creation activities that will be the basis for grouping students. *Secondly*, what student group can be formed based on their co-creation activities and what their characteristics. This group will represent a unique grouping of students based on the co-creation activities factors. *Finally*, it would be identified how marketing implications to serve students based on the groups.

By factor analysis, this study found five factors representing student co-creation activities, including feedback, helping, tolerance, responsible behavior, and information finding. *Feedback* is the factor indicating the degree of student giving feedback in learning process, such as telling to lecturer when they have an idea from learning activities, responding when the lecturer gives appealing explanation, and informing to lecturer when they have problem in receiving explanation in class. *Helping* is factor referring to the degree of students to help others in learning process, such as helping other students who have difficulty in completing coursework, helping other students who have problems in understanding course material, and teaching other students how to understand the course material. *Tolerance* is factor signifying the degree of student behavior in being tolerance in learning process, such as trying to understand when the class rescheduled by lecturer, being patient when lecturer takes inappropriate actions, and adjusting when the lecturer postponed the class. *Responsible behavior* is factor exhibiting the degree of students doing their student responsibility in learning and personal interaction, such as completing all coursework given by lecturer, meeting a minimum number of class attendance, following the direction of lecturer in how to do learning in class, listening carefully when lecturer explains, and greeting when they meet a lecturer. Finally, *information finding* is factor manifesting the degree of student in seeking and sharing information. It compose same activities, such as asking the lecturer when not knowing information about course works, looking for information about the course materials, informing the time they can attend in the conversations of class schedule replacement, informing lecturer about their assignment, communicating difficulty on understanding the course.

There are three groups formed based on co-creation activities factors, including higher, irregular and lower co-creator group. *Higher co-creator group* is characterized by highest degree of feedback, helping and responsible behavior. This group involves actively in giving feedback such as easily telling to lecturer when having idea, frequently responding to lecturer explanation, and straightforwardly inform to lecturer when they have problem in learning. Also, this group happy to help others in learning process, for instance helping for completing coursework, solving problem in understanding course material, teaching how to learn the course material to other students. Not only giving feedback and helping, this group is also showing highest responsibility to their obligation as student, for example doing all coursework, meeting a minimum number of class attendance, following lecturer guidance, listening carefully in class, and greeting when meeting a lecturer. Of the demographic characteristics, this group compose of more than half coming from private universities, male, in the 3rd semester, aged less than 30 years, and pay for their own tuition, while mostly is as professional. The other trait of this group is moderate in being tolerance and finding information. In summary, this group is the most active student group in learning, not only active to involve in learning with other students but also with their self.

*Irregular co-creator group* has the highest activities on being tolerance and finding information, even though the group has moderate on giving feedback and the lowest on helping and being responsible behavior. This group exhibits easily to understand when the class rescheduled by lecturer, to be patient when lecturer takes inappropriate actions, and to adjust when the lecturer postponed the class. Also, the group is the most active in finding information, for instance asking to lecturer, looking for information from various sources, informing the time they can attend in the conversations, informing lecturer about their assignment, and informing difficulty on understanding the course. In relation with helping and responsible behavior activities, the group is showing the lowest level in helping for completing coursework, solving problem in learning, teaching how to learn the course material to other students, doing all coursework, meeting a minimum number of attendance, following the direction of lecturer, listening carefully in class, and greeting when they meet a lecturer. Of the demographic characteristics, they are more than a half coming from public universities, female, in the 3rd semester, aged less than 30 years, and pay a little for their own tuition, while mostly are as professional. To sum up, this group is tending to permit, allow, understand, or accept something in learning process and actively finding information.

*Lower co-creator group* have unique characteristic from other group in term of co-creation activities. The most important differences are they have the lowest degree or less on co-creation activities such as giving feedback, being tolerance, and finding information; even though they have moderate degree on helping and responsible behavior. This student passively in giving feedback such as less telling to lecturer when having idea, rarely responding to lecturer explanation and less inform to lecturer when they have problem in learning. Also this student group is less happy to help others in learning process, for instance seldom helping for completing coursework, rarely solving problem in understanding course material, almost never teaching how to learn the course material to other students. Information is not important for them, so they are infrequently asking to lecturer, looking for information, and informing to lecturer about their assignment and difficulty. Of the demographic characteristics, they more than a half are coming from public universities, male, aged less than 30 years, and pay for their own tuition, while mostly are as professional and being in the 2nd semester. In short, this student group could be the most passive student among groups in co-creation activities.

Managerial implications for the student grouping are identified in order to maintain higher co-creator, to develop irregular co-creator, and to motivate lower co-creator. *Firstly*, university practitioners need to consider the important of experiential value and social influence in encourage co-creation activities (Shamim & Ghazali, 2014). By considering experiential value as a strategic tool in building value for student, both intrinsic values (customer return on investment and service excellence) and extrinsic values (aesthetic values and playfulness) would be strong determinants in developing co-creation activities, not only for student' participation but also their citizenship behavior. Also, social influence can be as a moderating factor in causal relationship of experiential value and co-creation behavior. As value co-creation is a social phenomenon, it is argued that compliance, internalization and identification would be strong moderators in the relationships of experiential value and customer value co-creation behavior.

*Secondly*, Lecturers need to enhance their relationships with students and increase student belonging (Cooper & Miness, 2014). Based on their characteristics, lecturer need to make personal and academic gestures of care through one-on-one - in addition to collective - interactions with students, they need to use their time with students to develop understanding

of students personally and make greater efforts to develop and illustrate understanding as virtue. The relationship also means that care must be taking to student when they have problem by taking initiatives, for instance through inviting student to co-create a feasible solution (Xu, Marshall, Edvardsson, & Tronvoll, 2014).

*Finally*, university need to consistently implement the models of higher education that both enlighten and empower students to achieve their potential in the long-term, in which the collective goal for lecturer and students alike must be to educate for a lifetime, not simply train for an immediate job opportunity (Judson & Taylor, 2014). For example, it needed to shift the overall emphasis in lecturer evaluation from the traditionally arbitrary student evaluations of lecturer "performance" to a more general emphasis of efficacy in enhancing the human capabilities of students.

## 6. CONCLUSION, IMPLICATIONS AND LIMITATIONS

The study confirm five factors underlying co-creation activities for student at master program, which consists of feedback, helping, tolerance, responsible behavior and information finding. The first three factors are similar with student extra role behaviors and the last two factors are student participation behaviors in value creation (Yi & Gong, 2013). Also, the study found three groups of student based on co-creation activities comprising higher, irregular and low co-creator group. They are difference in term of university type where they come from, gender, age, occupation, and how they pay the tuition fee.

Co-creation activities are needed to enhance value in higher education. In order to increase value for students, university needs to do some strategic actions on how to manage student co-creation activities. It is needed to maintain higher co-creator by developing tolerance and enhancing information finding, to develop irregular co-creator by enhancing feedback, helping and responsible behavior, and to motivate lower co-creator by stimulating information finding, tolerance and feedback as well as encouraging helping and responsible behavior. It could be achieved by considering the important of experiential value and social influence, to enhancing the relationship with students and increase student belonging, and implement the models of higher education that both enlighten and empower students.

There are a number of limitations in this study, which suggest expanding area for further research. *First*, the judgment method used as sampling technique would limit the generalization of this study to other contexts. *Second*, this study elaborates co-creation activities as a factor in grouping student and lecturer at master program. At this context, student personal relationships with lecturer are relatively equal because the age difference among them is relatively small, and the students have more rational consideration when choosing the program. Further research need to open an opportunity to examine undergraduate program context. It is needed because the undergraduate students are still having a relatively lower level of maturity, choosing the program that sometimes is not based on rational consideration, and the majority in number of student population at university. *Third*, this study focuses only on service learning as a core service for higher education. Future research needs to elaborate at difference services of higher education, for instance: administrative, dormitory, library or religious service at university. *Finally*, grouping of students in this study is based on co-creation activities with explanations only from the demographic perspective (e.g., age, occupation, or gender). It would contribute more to

knowledge development if future research also elaborates on other perspective such as differences in lifestyle, culture or country.



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# NEW PUBLIC MANAGEMENT IN HIGHER EDUCATION REFORMS : A CASE STUDY

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## 1. INTRODUCTION

This paper will focus on a particular product of university-based research that generated a significant impact on many institutions: New Public Management. In the last decades, it was the approach most commonly adopted for university reforms and implemented in higher education institutions all around the globe.

More specifically, my focus will be on issues that might arise when New Public Management reform is used as a tool to reshape the very institutions it emerged in. After introducing a model to assess both relevant parameters of reform waves and the (partially unintended) consequences unfolding in the process of implementation (Hood, 1998), I will illustrate the impact of New Public Management inspired reforms and some issues arising in the process of implementation by describing a particular case: Austrian Reforms of the University System. In the relevant sections, I will generously draw from an article published earlier with two colleagues (Burtscher et al., 2006) from which I would also retain the following introductory considerations as preliminary remarks.

All national university systems reveal the historical sediments that compose them. In the Austrian case this includes Catholic (notably Jesuit) influences, the reforms introduced under Enlightened Absolutism, a *Polizeistaat* regime extending into the universities under Metternich, the delayed importation of Humboldtian ideals which reasserted the autonomy of teaching and research, and the crushing of that autonomy under Austro-Fascism and National Socialism. The last of these - with its massive loss of talent and reputation - transformed a European intellectual powerhouse into a minor provincial system struggling, after 1945, to regain normality.

In what follows, the focus will be upon two more recent layers of sediment: that left by the events of 1968 on continental university systems, and that left by Austria's late conversion to the path taken by English-speaking universities since the late 1970s/early 1980s - the path towards what Marginson and Considine (2000) have called the "enterprise university", which is characterized by governance structures modelled on the private firm, and in which there is a greater emphasis upon "entrepreneurial" activity as a generator of non-state income. These two reform waves are neatly reflected in the two university laws (Universitätsorganisationsgesetz - UOG; *Universitätsgesetz* - UG) - UOG 1975 and UG 2002 - which capture with great clarity the spirit of these two policy moments.

The Austrian case is of interest for two reasons: first, because of the co-existence of deeply engrained traditions and experiments in organizational democracy (co-determination) in the 1970s; second, because of the rapidity with which current reforms seek to catch up with what are taken to be international developments in university management.

In order to sketch these developments, we shall work with a simplified typology of three ideal typical models of the university system:

1. *Guild model*: prior to the 1970s, Austrian universities - like their German counterparts - represented a paradigmatic example of the *Ordinarienuniversität*; the professorate enjoyed extensive powers within the system of guild-like selfadministration guaranteed by the state as regulator (see Krause, 1996). This is the base-line model that provides the context for the two subsequent developments with which we are primarily concerned.
2. *Democratized self-administration*: progressive democratizing reforms in the 1970s changed the rules of self-administration by empowering the non-professorial faculty (*Mittelbau*), non-faculty staff, and the students, while strengthening centralized state control and retaining rigid divisions between the “curia” (i.e. occupational status groups ascribed differential voting rights—professors, nonprofessional faculty, non-academic faculty, students).
3. *Service-oriented proxy market*: the 1990s saw the introduction of managerial elements (UOG, 1993) and the most recent university law (UG, 2002) has the explicit aim of modernizing the university system along the lines of the Anglo-American model by giving the universities formal autonomy from the state, introducing market competition, and considerably increasing the power of university management.

In none of these models is the university fully autonomous from the state. In the strictly Humboldtian university, the state as *Kulturstaat* respects the autonomy of the university’s internal decision-making while regulating it externally (a system of “pillarization”). The democratized model places new social demands upon the university, but likewise seeks to influence from without. In both of these systems, the state is nevertheless (accurately) still perceived as a major force. The market model promises full (legal) autonomy (one of its main selling points) while retaining effective control via old (e.g., financial) and newly introduced mechanisms.

By way of conclusion, I will adopt the *economy of conventions* perspective for an attempt to summarize some familiar features of internal dynamics within universities that make it particularly difficult to align all organizational units and the actors inhabiting them under one organisational umbrella and to manage them adopting one single approach.

## **2. A CONCEPTUAL FRAMEWORK: “ THE ART OF THE STATE”**

The theoretical perspective that informs this account is Christopher Hood’s analysis in *The Art of the State* (1998). Using Mary Douglas’s grid/group distinction Hood argues that organizational reform emerges as a reaction to the previously dominant model, and - as a reaction - seeks to drive the organization as far away from that previous model as possible.

According to Mary Douglas, virtually all groups/ communities and organizations/institutions can be characterised by the position they are holding along two dimensions: Grid and Group. “Grid” refers to the extent to which human communities are governed by conventions, i.e. the importance assigned to fixed rules and norms, while “Group” refers to the emphasis put on solidarity and cooperation among the members of a

social unit and is roughly corresponding to Durkheim’s notion of “moral density”. In one particular social unit more or less emphasis would be put on each dimension, with grid and group figuring as either high or low. This gives us four distinct community/organizational types (see Table 1).

**Table 1: Organizational ideal types**

GRID	GROUP	
	low	high
low	<b>Individualists:</b> atomized / individual bargaining: market-like	<b>Egaliterians:</b> high participation / “Every decision is up for grabs”
high	<b>Fatalists:</b> low-cooperation / rule-bound	<b>Hierachists:</b> socially cohesive / rule-bound

Source: Burtscher et al. (2006) adapted from Hood (1998)

With refreshing scepticism, Christopher Hood identifies the potential problems associated with all four conceivable organizational types, and is no less sceptical about the stability of hybrids given the centrifugal logic of human organizations, indeed of human communities.

The reforms with which we are concerned introduced new hierarchies into an already complex and pillarized system, destabilizing that system by creating new forms of polarization. Readers of Albert Hirschman (1982) or Christopher Hood (1998) would expect the latest wave of reform of the Austrian university system be a reaction against the previous model - a reaction that blamed all the faults of the present on that model, and sought to solve those problems by installing a system as far removed from its predecessor as possible. They would not be disappointed.

### 3. UNIVERSITY REFORMS IN AUSTRIA: TWO STAGES OF DEVELOPMENT

*Guild Model: The Ordinarienuiversität*

The *Ordinarienuiversität* was characterised by its strictly hierarchical structure. It had a distinct *Ständestaat* (polity of estates) quality in being composed of - all but ascribed - status groups with differential decision-making powers. Non-professorial status groups were effectively excluded from decision-making on grounds that were both formal and informal, the latter being a highly developed personal and specialist hierarchy. Rule by the professoriate (*Ordinarienuherrschafft*) was reinforced by a professional identity with a distinctly aristocratic and elitist character, and via a full-blown personality cult resulting from the central position within the German/Austrian system of the incumbent of the Chair (*Lehrstuhlinhaber*; see Stichweh 1994: p. 157). All this was reflected in the - often highly politicized - procedure for election to a chair. The increased level of functional hierarchy necessitated by industrialization, the transformation of universities into large-scale organizations, and the emergence of larger units within the universities reinforced these tendencies. Historically, these hierarchies were secured by the high degree of personal dependence of junior and younger faculty (*Assistenten/Privatdozenten*), whose lack of

material and job security served to increase the largesse that the professor was able to dispense (Weber, 1919,1948).

The autonomy of research, the university's claim within the dominant Humboldtian ideal to occupy a privileged place of scholarly withdrawal and universal truth, combined with its function for the social and cultural reproduction of the bourgeoisie (Elias, 1939,1994), afforded both its political content and legitimacy. The fact that universities were also places of political struggle, and of both emerging and declining ideologies, can be understood against the background of these interlinking characteristics and of universities' legitimation function. Industrialization and the expansion of the state (see Ringer 1969) meant a sudden increase in the demands on the universities, eventually subordinating the originally dominant function of cultural and social reproduction to that of assessment and the provision of credentials (Weber 1922: p. 576–579). Whatever the weight of its relative functions, the *Ordinarienuniversität's* right to administer its own affairs was far removed from pluralistic, egalitarian forms of democracy. The *Ordinarienuniversität* bore distinctly anti-democratic traits. The professor did not only have quasiownership rights over his (rarely her) post, but also over his institute and his assistants.

After the Second World War, universities in Austria were reconstituted in line with the consensus that dominated Austrian politics from the 1950s, but without altering these inherited structures. Thus, the *Hochschulorganisationsgesetz* (HOG) 1955 left the basic constitution of the *Ordinarienuniversität* intact. From the late 1960s onwards there was an expansion of the entire university system, the aim of which was to stimulate economic expansion by improving the qualification base in order to help generate technical progress. It was only then that the domination of the *Ordinarienuniversität* model came to be challenged.

#### *Democratized self-administration*

Although in comparison to Germany or France, 1968 in Austria was a mild affair, its universities were nonetheless deeply affected by the change of climate that the student revolts brought about. The 1970s also saw aspects of the student movement's antiauthoritarian and "anti-establishment" critique entering into mainstream political discourse and policy-making. In the Austrian case, this process was facilitated by the presence in power of a reforming social democratic party under Bruno Kreisky, which was able selectively to harness demands emerging from within civil society for its own political project. Demands for the democratization of public life were to impact upon university policy. The *Universitätsorganisationsgesetz* (UOG) 1975 embodied this societal critique in its democratizing intent, and can be viewed, in part, as a response to students' demands. The politicization of large sections of the - mostly young, educated, and middle class - population was expressed, within the university context, in the form of a demand on the part of the students and non-professorial faculty (the *Mittelbau*) for greater participation and a real say in decision-making, particularly given the fact that non-professorial faculty already undertook a large proportion of university duties.

More specifically, the still deeply traditional university was confronted with a demand for greater transparency, the aim of which was to weaken the privileges and powers of the *Ordinarien*, and in this way break through the oligarchic and paternalistic structures that rested upon them (Fischer-Kowalski and Strasser 1974: p.73).

The reforms contained in UOG 1975 - known as the Firnberg reforms after the Education Minister, Hertha Firnberg, who introduced them - reconstituted the composition of



decision-making bodies within the university according to the following ratios (professors:non-professorial faculty:students): at the departmental level and on teaching committees 1:1:1, and at and above faculty level 2:1:1. Non-academic members of staff were also given a degree of representation at all levels. Decisions were to be reached by majority decision, and working committees were set up to consider key policy issues. In brief, a principle of *Mitbestimmung* (co-determination) was installed within the universities. In the core areas in which the universities enjoyed autonomy (research and teaching) they were permitted to arrive at their own decisions, while other competencies (including the elections of chairs from a list of three drawn up by the university) were to remain within the Ministry.

Two things should be noted about these reforms before we examine the more recent developments that are reactions against them. First, while redressing the balance of power within the university, the curia structure - and thus elements of the *Ständestaat* - remained intact. Second, the reforms had an economic rationale that is easily overlooked. Not only was a new planning and control system introduced, but the entire administration was centralized and the Ministry's right to oversee university business, and its access to information, was strengthened by binding the university directors more closely to the Ministry. In this way the further rationalization of the universities could be pursued (Ferz, 2000: p. 482). Thus, increased efficiency was just as much a cornerstone of UOG 1975 as democratization. The path was cleared for the transformation of an elite system into a mass university system.

Not only do the structures of contemporary universities contain historical sediments, universities have also in the course of time acquired new functions without shedding older ones. These too are layered one upon the other. With the Firnberg reforms, Austrian universities had acquired an additional function, at least in the minds of some younger faculty: they were to be places of *societal* critique with an emancipatory purpose. Not only are these various functions and conceptions still there: they also represent ideals and identities not merely for individuals who understand their vocation in terms of some of these functions to the exclusion of others, but also for disciplines or status groups. These conceptions often confront each other as mutually hostile and competing factions. Into this already contested space, in which humanists confront scientists, transitionally-minded *Ordinarien* confront self-proclaimed progressive faculty, and so on, steps the latest contender: the notion of the university as knowledge cluster; as regional income generator; as competitor in an open, or opening, market for students and for (pure and applied) research income; as managed modern enterprise. How is this playing out in the Austrian case?

#### **4. NEW WAVE REFORM: NEW PUBLIC MANAGEMENT AT WORK**

It is far easier for would-be reformers to change the formal structure of an institution than to change its practices. Redesigning the lines and boxes in an organizational chart is simpler than changing how that organization in fact operates. Changing the rules and regulations is simpler than eliciting behaviour that conforms to them. (Scott, 1998)

Readers of Albert Hirschman (1982) or Christopher Hood (1998) would expect the latest wave of reform to be a reaction against the previous model - a reaction that blamed all the faults of the present on that model, and sought to solve those problems by installing a system as far removed from its predecessor as possible. They would not be disappointed. The third and final stage of our narrative is represented by the UG 2002 (implemented on 1

January 2004), the explicit aim of which is to modernize the university system in line with developments within the EU (particularly the Bologna Declaration) and in the name of internationalization.<sup>5</sup> With respect to the latter, it is the Anglo-American model, at least as this is locally understood, that provides the frame of reference. This model is taken to be more dynamic, innovative, responsive to external demands, and better managed (cf. Clark 1998). It is also seen as the polar opposite of the centralized but internally weakly managed Austrian system. Although current university reform is part of the program of the ÖVP/FPÖ coalition whose rise to power in 2000 marked the end of Austria's long period of social partnership and consensus politics (Pelinka, 2002), there is some indication that the political debate had already been moving in this direction.

The philosophy behind the latest wave of reform can be clearly seen in the published advice the Ministry was receiving from external advisors, who emphasized the lack of both cooperation and competition within the system, and *de facto* reformblocking veto enjoyed by faculty. UOG 1993, which introduced partial university autonomy, was to be assessed by an independent commission (*Universitätenkuratorium*) that operated between 1994 and 2003. Its annual parliamentary reports provide rich insight into developing policy thinking (see *Universitätenkuratorium*, 1999: p. 21-22) After expressing concern, for example about the slowness and unevenness of the implementation of partial autonomy (*Teilrechtsfähigkeit*), in their early reports, by 1999 the commission was making proposals for a much more radical overhaul of the university system. The language and the concrete proposals of the *Kuratorium* found their way not just into political discourse, but also into the statute books in the form of our second law, UG 2002.

If UOG 1975 bore the marks of the - post-68 - *Zeitgeist*, then UG 2002 is no less a *Zeitdokument*, but times have changed. If the state in general, and the *Rechtsstaat* in particular, speaks the language of the law (see Poggi 1990: 29), UG 2002 represents the moment in Austria in which the state started to speak the language of modern management science. The discourse around the new university law contains slogans such as *Auf in die Weltklasse* (Up and away into the world class [university system]), *Aufbruch in die Autonomie: Ausbruch aus tradierten Universitätsstrukturen* (Liberation into autonomy: breaking out of staid university structures; BM:BWK 2003), and so on.

Hood characterizes the discourse of modern public management by referring back to classical rhetoric, including that rhetorical device Aristotle called "enthymeme": "a foreshortened chain of reasoning, with key premises suppressed, so the conclusion flows swiftly and apparently effortlessly from a few stages of argument" (Hood 1998: p.175). He goes on to note that "enthymeme often consists of a maxim followed by a chain of selected examples, with selective illustrations being used for proof" (Hood 1998: p.176). It is not difficult to find this, and other rhetorical devices, being deployed in the documentation that surrounded the introduction of UG 2002 as linguistic devices used to destroy the legitimacy of the internal participatory democracy model. Nor is it difficult, as one would again expect given Hood's analysis, to find equally rhetorical counter moves being deployed in defence of that model.

But UG 2002 is more than a text, it is a law. It prescribes a set of control mechanisms, the implementation of which fundamentally alters the contract between the university and the state as well as the university's internal constitution. The Ministry (of Education, Science, and Culture [BM: BWK]) will no longer bear direct operative responsibility for the universities. The latter are autonomous public bodies (legal persons) in receipt of a block



grant over which they formally have full control. The new contracts between the state and the universities were to have taken the form of negotiated performance agreements (*Leistungsvereinbarungen*) tied to resources; the fulfilment of these agreements was to have been determined by regular evaluation.<sup>6</sup> But the Ministry has sought to retain a degree of *de facto* control over higher education in another way, namely by constituting university councils (*Universitätsräte*) - modelled on the US boards - in the appointment of whose members it has a disproportional say.<sup>8</sup> These councils in fact have extensive powers, given their function of overseeing the internal affairs of the newly autonomous universities.

UG 2002 represents not merely a change in the contract between the state and the universities, but also a paradigm shift in the management model *within* the universities. It installs a centralized authority structure in place of internally democratic decisionmaking. The rector is now for the first time a true CEO with extensive powers attached to his (there are no women rectors) office and to the team of vice-rectors. Whereas rectors had previously been elected by faculty, non-academic staff, and student representatives, they are now selected by the university council from a list (of three names) drawn up by the University Senate. Centralization of power within the universities (i.e., the increased authority of senior managers) has also been made possible by the removal of competences from the senate and by the further weakening - in effect abolition - of co-determination at both the curia and faculty levels. Thus, for example, whereas deans and heads of institute were elected by their faculty or institute, their successors will be selected (from a list drawn up by professorial curia) by the rector.

The obvious losers are the students and the *Mittelbau*, whose representation on key committees (including the senate) has been drastically reduced. Although the professors as a curia have been strengthened *vis-à-vis* other curia in bodies such as the Senate, those bodies themselves have lost competences. One likely outcome is that new informal hierarchies will emerge in which some professors (and those enjoying their largesse) will gain and others lose. The obstacles to wholesale organizational reform have been removed and the rector's team is now free, indeed strongly encouraged, to experiment with the university's internal structures in the hope of altering established behavioural patterns. The more positive aspect of this reorientation is that the rights of non-professorial faculty to conduct externally-funded projects have been strengthened.

The organizational reforms are necessarily accompanied by legal changes in employment status. New faculty will not only no longer be tenured civil servants, but will be in private employment, frequently on temporary contracts with lower levels of job protection.<sup>9</sup> This again strengthens the hand of management *vis-à-vis* faculty. If the UOG 75, with its emphasis on guaranteed rights of co-determination and on employment security, encouraged a horizontal polarization along curia lines, UG 2002 has created a new vertical polarization between management and staff. For example, even in the early stage of implementation, we can see a growing wage disparity between senior management and the non-tenured staff, and precarious employment relations. At the same time, the older divisions - for example between curia - remain; these additional sedimentations further weaken the voice of faculty.

All this represents a paradigmatic shift away from a collegial conception of the inner life of the university - strong Senate/strong deans/weak rector - to a managerial conception: strong rector/weak Senate/weak deans (or heads of division). The rectors and his team now make the operative decisions - including those concerning the internal steering of the

organization - with the competence of the Senate being largely reduced to curricular matters, and to reviewing and approving university statutes. In place of the steering of the university activities taking place via modes of bureaucratic regulation, (new public) management measures have been introduced in order to encourage an orientation towards outcomes and performance. Just as the university has to draw up performance agreements with the Ministry, the individual units within the university are to draw up similar contracts with the Rector (*Zielvereinbarungen*), creating a transparent chain of responsibilities. The impact of these ideas is already manifest in the measures designed to bring internal university structures in line with the new dispensation via delayering, harmonization (also in the context of the Bologna Declaration), and an emphasis upon strategic development in teaching and research (so-called *Profilbildung*).

## 5. THE STATE OF OUR ARTS: FUZZY LOGICS OF UNIVERSITIES AND THE PRIMITIVE LOGICS OF HIGHER EDUCATION REFORMS

To conclude, I would like to sketch a picture of internal dynamics playing out at many universities that make it difficult to align all its parts and members while adopting one single managerial approach. In the rather recent tradition of the *economy of conventions* and *pragmatic sociology of critique* ‘orders of worth’ constitute the way in which philosophical notions of justice find their way into common sense and are echoed in everyday discourse and practice, thus acquiring ‘validity’ and providing legitimation for a variety of social (sub-) systems (see Scott and Pasqualoni 2014 for a more extensive discussion). Using three sources of data, Boltanski and Thévenot (2006; French original 1991) identify six such orders. In listing these, in each case I will mention the classical ‘source’ to which they ascribe the standard of justification and will seek to make their significance clearer by briefly identifying their equivalent in a number of real existing universities (Pasqualoni, 2005):

*The world of inspiration* (source: St Augustine’s writings): an order of worth illuminated through passion, imagination, creativity, ingenuity, even holiness and grace ‘as an immediate relationship to an external source from which all possible worth flows’ (Boltanski & Thévenot 1999: p. 370). *Example*: niche university environments often embodied by those academic subjects inhabiting the literature, artistic and philosophical field which, according to Bourdieu (1985), cultivate, celebrate, and indeed rest upon, values of originality rather than truth.

*The domestic world* (source: the 17th century French theologian Jacques-Bénigne Bossuet): a family-like order generated and maintained through established hierarchies in which worth (‘greatness’; *grandeur*) is acquired by holding a determinate place in ‘a hierarchy of trust’ which is ‘based on a chain of personal dependencies’ (Boltanski and Thévenot 1999: 370). *Example*: the dominant role of the *Ordinarius* (full professor) in the Prussian university system, which still casts a long shadow over the contemporary German university systems (cf. Stichweh 1994: p. 157) and high profile research institutions (e.g. Max Planck Institutes).

*The world of renown* (source: Thomas Hobbes): Boltanski and Thévenot take their cue from the chapter on honour (ch.10) in *Leviathan* in which Hobbes argued that worth relies on public opinion and esteem, fame, and respect and acknowledgement or recognition

by others. *Example*: scholarly and/or scientific reputation with one's peers remains a – if not *the* – currency with which academic achievements are rewarded.

*The civic world* (source: Rousseau's *contrat social*): 'a sovereign is formed by the convergence of human wills, as citizens give up their particular interests and direct themselves exclusively towards the common good' (Boltanski and Thévenot 1999: p. 371), an attitude which makes up the value of each member of such a disembodied community. *Example*: the 'spirit of '68' in several Continental European university systems embodied (or believed themselves to embody) such an order of worth; something made evident in attempts to resist more recent 'neo-liberal' reform moves (see Burtscher *et al.*, 2006).

*The market world* (source: Adam Smith's account of the working of markets): 'The market link coordinates individuals through the mediation of scarce goods, the acquisition of which is pursued by everybody' (Boltanski & Thévenot 1999: p. 372). *Example*: competitive funding for both research and teaching or the role of league tables in enhancing a sense of competition (see Sanders & Espeland, 2009).

*The industrial world* (source: Saint Simon): efficiency and the figure of the expert (depending on his/her position on a scale of professional capabilities) are the leading values. *Example*: via the characteristic hierarchical qualification system for academics, now reinforced through various kinds of performance measures, universities are increasingly reliant upon such repertoires of industrial production.

Boltanski and Chiapello (1999; English translation 2005) argue that project-based work is not only an increasingly dominant form, but also a key source of contemporary capitalism's legitimation. This move added a further order of worth:

*the project-oriented (or 'connectionist') world* the influence of which is not only evident in current academic landscapes, but also mirrored by recent legislation in the realm of Higher Education (see Burtscher *et al.*, 2006 for the Austrian case) and a number of governance tools at the level of universities.

Further empirical analysis might focus on the plurality of these orders of worth and their co-existence within the same system / organization. This gives rise to disputes and conflicts within organizations concerning practices and governance instruments. These orders are conceived as mobile and flexible and allow to identify fundamental tensions or even dilemmas. Critical tensions – both within and between orders of worth – represent a promising research topic for governance analysis and could contribute to explain some of the – not least reverse – effects of governance instruments, especially in the process of their implementation.

In this spirit, the present paper could also be read as an example of such orders at work in Austrian universities.

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**VOICING EXPECTATIONS AND EXPERIENCES OF UNDERGRADUATE  
STUDENTS TOWARD THE ENTREPRENEURIAL EDUCATION  
: A COMPARISON OF THAI AND INTERNATIONAL PROGRAMS**

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**ABSTRACT**

This research addresses the inadequacy of literature of Thailand's entrepreneurship education explaining expectations and experiences of university students who are studying in the bachelor's degree program in entrepreneurship. The principal concentrations are (1) to investigate and (2) to comprehend student's expectations and their experiences toward entrepreneurial education since it is on an upward trend in Thailand. A number of Thai universities are now offering the degree in entrepreneurship but few empirical studies about this issue are highly sought by both scholars and university executives. The study collected data from diverse groups of students who are studying in the Thai and international programs ranging from the freshman to the senior at Bangkok University School of Entrepreneurship and Management (BUSEM). BUSEM is selected because it is the largest and the most active school in the Kingdom that focuses on producing entrepreneurs through its exclusive curriculums and research programs under the collaboration with Babson College, USA. The findings showed that personal interest in a particular occupation, influence of family, and personal lifestyle were motivations to progress in entrepreneurship education.

**Keywords:** entrepreneurship, entrepreneurship education, student expectation, student experience, Thailand



# **VOICING EXPECTATIONS AND EXPERIENCES OF UNDERGRADUATE STUDENTS TOWARD THE ENTREPRENEURIAL EDUCATION : A COMPARISON OF THAI AND INTERNATIONAL PROGRAMS**

## **1. INTRODUCTION**

This research addresses the inadequacy of literature of Thailand's entrepreneurship education explaining expectations and experiences of university students who are studying in the bachelor's degree program in entrepreneurship. The principal concentrations are (1) to investigate and (2) to comprehend student's expectations and their experiences toward entrepreneurial education since it is on an upward trend in Thailand. A number of Thai universities are now offering the degree in entrepreneurship but few empirical studies about this issue are highly sought by both scholars and university executives.

In Thailand, the entrepreneurship has obviously been appeared as one of national agendas when Thaksin Shinawatra administrated the country in 2001. There were many entrepreneurial projects launching to improve quality of life of local people and also to increase competitiveness of Thailand in the global trade. In fostering national entrepreneurship, few specific mechanisms were established such as Office of Small and Medium Enterprises Promotion (OSMEP), Institute for small and Medium Enterprises Development (ISMED), SME Bank, and Thai Credit Guarantee Corporation (TCG). In 2002, the One-Tambon-One-Product (OTOP) project was officially announced in order to encourage local people to commercialize their local wisdom, goods, and services. OTOP means every sub district must have one product. The great challenge of the government, which then transformed to be the difficulty, was to encourage people to think entrepreneurially. Since that time, the entrepreneurship agenda has been spoken nationwide. Universities as an important social institution have been catching this opportunity to offer training and regular courses to people in different levels. Since then, entrepreneurial mindset has been socialized in the Thai society.

Currently, the entrepreneurship is the urgent agenda of the globe. A number of new generations are heading to commercialize their ideas and trying hard to introduce their new creative products and services to the global marketplace. This global megatrend also significantly impact on Thailand as the number of start up labs, incubators, and venture capitalists are being increased such as Dentsu Start Up Lab, HTC Boot Camp, Invent, etc. Therefore, public and private universities do not miss the chance to leverage their reputation by offering some specific degree courses focusing on entrepreneurship. Anyway, there are only two universities, Bangkok University (BU) and the University of the Thai Chamber of Commerce (UTCC), which have the entrepreneurship education unit as school or college. In these two universities, Bangkok University is the first one, which establishes the entrepreneurship department, and then School of Entrepreneurship and Management (BUSEM) since 2005. Moreover, BUSEM is the only one higher educational institution in Thailand, which has collaboration with Babson College, 1<sup>st</sup> ranked in the USA Today for 23 consecutive years, in both curriculum design and two global research projects: Global Entrepreneurship Monitor (GEM) and Successful Transgenerational Entrepreneurship Practices (STEP). However, there are no research about student's perceptions and experience in this unique institution. Thus, this research is beneficial to policy decision makers, higher



education executives, and entrepreneurs in developing effectiveness of Thailand's entrepreneurial education in the future.

## 2. LITERATURE REVIEW

### **Motivations for entering higher education**

A range of reasons why students choose to progress to university is very important factor because it is the foundation of understanding their learning behaviors. A study of Houle (1961) is one of most cited empirical studies about student's motives. According to Houle, there are three main reasons: goal, learning, and activity. Goal motivation refers to students' desire to achieve specific vocational outcomes because they see education as a factor that is able to help and lead them to their career destination. Learning motivation concerns students' desire to progress to university because they truly enjoy learning environment in order to strengthen their intellectual thoughts and growth. Activity motivation involves a desire to create new social network because students see university as the center of society and probably the best place to strengthen their own network. Clark and Trow (1966) confirmed Houle that there are three motives influencing student's choice of choosing university as well as Bolger and Somech (2002), which described in the terms scholastic, vocational, and collegiate. In a recent empirical study undertaken by Kember, Ho, and Hong (2010) identified student's motivations into six factors, which also align closely to the previous studies of Houle (1961), Clark and Trow (1966), and Bolger and Somech (2002).

According to Kember, Ho, and Hong (2010), the motivations are as follows:

- (1) Compliance. It refers to an understanding of students to recognize that it is normal to further higher study in university;
- (2) Individual goal. It concerns a desire of taking education as far as students can;
- (3) University lifestyle. It is a motivation of students to take part in university for doing various kinds of social and other recreation activities;
- (4) Sense of belonging. It refers to the influence of family, friends, and surrounding people on student's decision to register at university;
- (5) Career. It is a desire to enroll at university for satisfying specific career aspiration;
- (6) Interest. It refers to a desire to go to university to pursue a private interest in a particular occupation

### **Expectations of higher education**

Kuh (1999) defined expectations as an individual's anticipation of future situations in various conditions. Students are also similar. They have varied anticipations concerning to further study in university. Bennett, Kottasz, and Nocciolino (2007) suggested that there are four factors impacting levels of expectation, which are student's prior experiences, their academic self-concept, promotional material, and exposure to current students or graduates. Pike (2006) pointed out that student's expectations usually affect on their selection of academic discipline because they normally choose discipline to align their degree program with capabilities, interests and personality. Past studies obviously revealed that it is the important responsibility of university to balance students' expectations and their experiences because when expectations are not met, it may cause students to change their program of study or withdraw from university (Baker, Mc Neil, & Siryk, 1985; Braxton, Vesper, & Hossler, 1995; Bennett et al., 2007).

### **3. METHODOLOGY**

The study collected data from diverse groups of students who are studying in the Thai and international programs ranging from the freshman to the senior at Bangkok University School of Entrepreneurship and Management (BUSEM). BUSEM is selected because it is the largest and the most active school in the Kingdom that focuses on producing entrepreneurs through its exclusive curriculums and research programs under the collaboration with Babson College, USA.

Semi structured qualitative in-depth interview was conducted in order to understand in-depth expectations and experiences. Each interview lasted on average one hour. However, the participants did not agree to be recorded. Hence, detailed records were taken during the interviews. The interview contents were manually analyzed and guided by the research questions in the identification of key themes that have emerged. Sixteen interviews were conducted with BUSEM's students in Thai, and then interpreted into English.

For ensuring participants' privacy, their name and surname were modified. Throughout the interviews, a number of questions and issues were discussed and examined along the following themes. The first theme was focused on participant's personal background, previous and current career expectations. Afterwards, the interview was emphasized on student's motivations and perceptions on entrepreneurial education at BUSEM.

In data analysis, Layder's approach (Layder 1998) was conducted. Theories, concepts, and past empirical research results were taken into account, while the research still remain open chance for interpretation that emerge from the data itself. Data was coded and assessed several times prior to select important sections and sorted by theme. All subjective data of the interviewees were evaluated and analyzed throughout the evaluation and comparison of common issues. However, data was also analyzed during the interview. The researcher intended to look for insight in which situation, setting, images, and meaning were key issues. Therefore, the communication of meaning, the amount of times a definite phrase or speech pattern, and the frequency and variety of messages was the unit of measurement. The advantage of using the researcher, rather than software programs, to analyze the data was to encourage the opportunities to obtain insightful interpretations as well argued by Suddaby (2006).

### **4. RESULTS AND DISCUSSION**

#### **Motivations and expectations**

The key motives that influence students to progress to the degree program in entrepreneurship both Thai and international are personal interest in a particular occupation, influence of family, and personal lifestyle, respectively.

Personal interest in a particular occupation was revealed as the most important motive because students would like to fulfill their individual interest in specific business both related and unrelated to their family business. Unrelated occupation does not mean different occupation from student's family business. They would still like to connect their individual interest with family business because they believe that it is a responsibility to sustain

performance of the business and to expand as much as they can, if possible. The results support Kember, Ho, and Hong (2010).

I compared many schools and universities before my decision was made. I chose BUSEM because I prefer its name and goal in producing creative entrepreneurs. This matches with my interest in expanding family business after graduation...(First year student in Thai program).

BUSEM has unique that fit with my interest. I would like to create my own venture in the near future. I came here because I would like to increase my creativity that encourages my strengths... (Second year student in international program).

According to Kember, Ho, and Hong (2010) about sense of belonging, this current found the results that family member influence particularly parents was found as another crucial factor that affect on student's choice of their discipline selection. Students revealed that they ultimately understand that it is usual for everyone graduating high school to enroll in university. Therefore, a difficult question is what discipline they should decide to study and create their expertise. In doing this, the study revealed that it is very difficult for students to choose their program of study by themselves. Particularly, the elder son or daughter indicated this issue as the most important. Therefore, parents are those who are firstly consulted. In many cases, family members, e.g. elder brother or sister, also play an important role in this situation because they may share their experiences, recommend direction, and assist students to form their career plan.

My father and mother encouraged me to apply for this program. That time, I was very confused about what direction I should go to and what expertise I should strengthen. Father is the first person who introduces me to recognize this entrepreneurship school. Now, I think it is fit with my interest and so clear about my future career path as an entrepreneur... (Third year student in international program).

After I realized the result of the university entrance examination, I consulted with my father and mother about this program. I knew the program when I was in Mattayom 6 but I was not sure that it is appropriate for me or not. My parents gave me a lot of information. Apart from the parents, my elder brother was also the one who encourages me to enroll in this program...(Fourth year student in Thai program).

Personal lifestyle was disclosed its importance after personal interest and family member influence because students consider an importance of family business before to satisfy their personal life. Although, family members play a crucial role in the decision making process but students still base a final decision on their lifestyle. When a discipline and lifestyle are not matched, students usually try to compromise their choice and solution for balancing their preference and family responsibility.

I would like to do what I am really interested but I have to think of the family first. The business administration discipline is very popular among friends and relatives but entrepreneurship is clearer for me. I am able to fulfill my interest because entrepreneurship gives freedom to think and pursue my dream. Entrepreneurship is a multidisciplinary program...(Second year student in Thai program).

I will initiate a new venture after graduation but I will choose the business I am interested. This is the key reason I choose to study entrepreneurship. I used to think to study in a multimedia design but I have to think of family as well. If I should to pursue my dream without caring the parents, I may regret one day in the future. I don't want to disappoint the ones I love...(Second year student in international program).

Prior to enroll in School of Entrepreneurship and Management, students believe the school will be able to help them to achieve vocational outcomes. Furthermore, students also anticipate gaining more business ideas that will be beneficial for their own or family business in the future. The major factors leading students to expect and believe that are the unique curriculum, highly practical learning approaches, collaboration with American leading entrepreneurship institution, and the university reputation.

Bangkok University is very unique for me. I like the slogan "creative university". It is not just a slogan but BU offers creative activities and facilities continuously...(Third year student in Thai program).

I didn't enroll at other leading private universities because I compared BU with them and found that BU is outstanding in both concept and reality. I asked a lot of friends, brother, sister, parents, and alumni for ensuring I made the best decision...(First year student in International program).

Personally, BU's focus on building creativity and entrepreneurship is the best for me. It increases my confidence in decision and myself...(Fourth year student in Thai program).

## **Experience**

Practical learning approaches were revealed as the most influential factor leading to an effort of learning. Business professional lecturer was revealed as an important reason that satisfies students. The study revealed that students see business professional lecturers as value added of the program but the school needs to balance a mixture of professional and scholastic ones because business professional sometimes has a limitation of delivery management concepts and theories. This point was considered as a significant issue in the study, because students would also like to cultivate experiences, perspectives, and ideas of successful entrepreneurs as well as to recognize a link of those experiences and systematic thought. The study disclosed that students have been satisfied with learning approaches and knowledge, perspectives, and ideas gained from the program of study. A number of businesspeople have been invited to lecture almost every subject both Thai and International programs. Although, students are afraid to ask questions they want during the lectures but they usually talk with the guests after the lectures, which makes them to feel more comfortable. Students in Thai and international program were similar in learning style and expectations. They do expect to have business ideas and projects before graduation. The school is able to deliver courses and activities to meet with their anticipation as mentioned earlier.

Collaboration with Babson College was emerged during the interview because students look it as one of crucial points in the decision-making process. But students pointed out that they do not recognize the link between their current curriculum and the Babson's.

However, they are confident that their program is tough. They have to practice the business experience activities every year before passing to higher level. These activities are difficult but they learn a lot such as how to manage a business plan and how to coping with business difficulties efficiently and effectively.

Obviously, reputation of the university was considered as more important than reputation of the school. An outstanding position among other public and private universities is a magnet to motivate students and also create their expectations. As the creative university, Bangkok University (BU), has been sitting in students' mind since they are planning to enroll in university. In Thailand, one reason affecting on student's decision-making process and solution is a belief of quality of public and private universities. In the Thai society, people still believe that teaching quality including learning approaches of public universities are better than the private ones. Therefore, students usually keep the public university in mind and try to enter through the national examination. This currently study found that ten out of sixteen students chose to enroll at BUSEM because they clearly understand themselves about what they would like to do in the near future. Moreover, they believe in Bangkok University's reputation as the creative university. Prior to enroll, students expect to gain new ideas from lecturers, guest speakers, learning approaches, and activities of both school and university. After their enrollment, students found that the expectations and experiences are met. Bangkok University provides activities and facilities supporting their learning creatively. Students revealed that the experiences gain at BUSEM and BU are extraordinary because they are not able to obtain from studying at other leading private universities in the same level.

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**PUBLIC PRIVATE PARTNERSHIP AND COUNTRY DEVELOPMENT:  
A CASE STUDY OF BUILD-OPERATE TRANSFER ROAD CONSTRUCTION  
IN MYANMAR**

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**ABSTRACT**

Nowadays, Public Private Partnership projects (PPPs) are used both in developed and developing countries around the world to encourage private sector to manage and operate the infrastructure projects. Infrastructure development must be improved as the first priority for Country's economy. As transportation is essential for public infrastructure development, Myanmar Government creates the PPPs model as the Build-Operate-Transfer (BOT) based - model in road construction, depending on its own rules and regulations. BOT projects in Myanmar are based on the traffic demand to serve the people's needs. By means of liberalization in the restricted rules and regulations of the public services, government attracts the private sectors to participate in those projects with a suitable model. Although under the country's Socialism time, State Economic Enterprises (SEE) had been involved in power, energy, mining, construction, manufacturing, etc, new government has changed the policy to enhance the private sector's investment in public services. The right project, the right place and the right situation are important in partnership between public and private sectors. Therefore, relevant and flexible rules and regulations need to be laid down for both public and private benefits in Myanmar. To attract the local and foreign investors, Myanmar government should revise Foreign Direct Investment (FDI) law and lay down the flexible PPP Law and reliable banking system as quickly as possible. Although the development of transportation sector alone cannot fully support the country's development, BOT road construction projects are really required to support and enhance the country's political, economic and social development.

Keywords: Public Private Partnership (PPPs), Build-Operate-Transfer (BOT), State Economic Enterprises (SEE), Foreign Direct Investment (FDI) law

# **PUBLIC PRIVATE PARTNERSHIP AND COUNTRY DEVELOPMENT: A CASE STUDY OF BUILD-OPERATE TRANSFER ROAD CONSTRUCTION IN MYANMAR**

## **1. INTRODUCTION**

Public Private Partnership (PPP) is a long-term project, implemented by private funds to invest in public infrastructure and services (UN/ECE Forum, 2000). Different countries (For example: the United Kingdom, the United States, Australia, South East Asia Nations, etc.) practice PPP in different way and methods according to their legal framework and perspectives.

By means of PPP, private sector is beneficial for public interest (Kaparos, 2005) because it is efficient in time, cost and quality in those projects (Bansal,2012). Nowadays, PPP projects are used both in developed and developing countries around the world. PPPs encourage private sector to manage and operate the infrastructure projects from demand – based to the service-based (Harding et al, .2010). Implementation of infrastructure projects takes long depending on the specific projects. The costs for those projects are huge so government cannot fulfil all the infrastructure projects for its citizens' requirements. Moreover, an account of the projects being the long term ones, the efficient qualities are needed due to the design of partnership. Private must be keenly interested in the provision of the public sectors (Lam, 2005). By means of liberalization in the restricted rules and regulations of the public services, government needs to attract the private sectors to participate in those projects. The major advantages of PPPs are based on the theoretical and practical situation now. Choosing a suitable model in the practical field is essential for PPPs. So, it is also noted that right project, right place and right situation are important in partnership between public and private sectors. Relevant and flexible rules and regulations need to be laid down for the success of PPP and both for public and private benefits.

To get the required funds and lighten the burden on the public sector, Myanmar government has adopted the roads privatization scheme. Both local and international companies are invited to invest in road construction. Now, PPPs road construction projects with BOT system basis are being gradually developed in Myanmar. Handley (1997) mentioned that there are several attractive features of BOT: private sector's finance in the development projects, commercial incentives, the quickest and most efficient way of infrastructure facilities installations, better management, infrastructure development and arising taxes from privatization process and improvement of government income. Local investors are much more interested in those projects. They need to familiarize themselves the awareness and experience and success of PPPs projects more.

As infrastructure development is an essential role in Myanmar, government has changed the policy to enhance the private sector's investment in public services. In the years 1962-1988 in Socialist time, State Economic Enterprises (SEE) in Myanmar took the key role in power, energy, mining, construction, manufacturing, etc. About 60 Percent of public investment and about 45 per cent of total investment in the economy were undertaken by SEE(Than &Tan., 1990).Myanmar economy was declining in the Socialist time because of the inward –looking strategy of close –door economy and nationalization. At that time, local private sector role was automatically declining and foreign investors could be seen



withdrawing their investment. As a result, foreign direct investments were scarce and there was lack of technology for infrastructure development. Consequently, human resource development became weaker. Although Myanmar possesses national resources, enough value-added material could not be produced for the citizens, let alone for export. Along with the declining in export material rate, income of foreign currency went down and foreign currency was spent more on import materials. Income and outcome were not balanced. Due to the restricted banking systems, only public owned banks could stand and operate but domestic banks could not operate. Moreover, the inflation of local currency or money was high in Myanmar. This was one of the main reasons of Myanmar economy declination. In the mid-1980s, Asian countries changed the policy in infrastructure projects and started to introduce PPP projects with BOT concession (Handley,1997). Myanmar government began to adopt open market economic policy and invited private sectors to operate in PPP projects in 1996. Asia World Company (AWC) started BOT road construction in late 1996. Now, Myanmar has about 157,059 km of road networks but the total road length of MoC is 40128.6km including BOT road 5620 km with 28 companies in 63 road projects (MoC,2015). Most of the roads had been constructed by responsible Ministries by Government funds before BOT road construction companies joined in 1996. Enhancing participation of local companies as well as foreign companies in BOT road construction projects is needed in Myanmar. Therefore, the objectives of this research paper are to identify the role of PPP with BOT road construction in Myanmar's development, to examine the key success factors (KSF) of BOT road construction system practicing in Myanmar and to examine the benefits of BOT road construction for local and foreign investors which will support the country's development.

This research paper focuses on qualitative research method or approach with research questions as follows:

1. To what extent can PPP projects with BOT road construction in Myanmar enhance the country's development?
2. What are the key success factors (KSF) of BOT road construction in Myanmar?
3. How do local/ foreign investors of BOT road construction projects play an essential role to support Myanmar's development?

This research paper focuses on Public Private Partnership or PPP Theory. PPP phenomena is very useful in infrastructure development of the country which takes time and needs huge investment .PPP is "arrangement where private sector supplies infrastructure assets and services that traditionally have been provided by government" (Urio, 2010). Myanmar government liberalized in road construction service and invited private sector to participate in PPP projects with the BOT system. Qualitative research is suitable for this paper. This study places an emphasis on finding out the experience and observation of the people who are doing BOT projects in road construction. This method is very useful and reliable in examining the reality of the individuals and target groups.

This paper explores especially BOT road construction model in Myanmar. It does not study the development of infrastructure related projects in transportation sector such as rail transportation, bridge construction, etc. It is limited to BOT road construction system only. Myanmar government is willing to promote the private sector participation in the road construction and to implement those projects successfully. The risks sharing is one of key issues in the PPP projects. This research analyses how to overcome the risks by the public and private sector in the implementation of those projects. It is beneficial for the public and private investors in the road construction.

BOT are joint venture projects with the public and private companies so public sectors share their road technology to the private sector. This is a good opportunity to learn the technological know-how and extend their market widely. So, both sides can get benefits. Regional people have the opportunities to get more jobs and as the transportation is smoother and easier, they can communicate one another. More commodities will be transported more than before and the cost of commodities will be low. Local people will unavoidably experience both good and bad effects that come with modern technology.

Realizing the requirement of a huge amount of budget for long term projects, government considers and gives the incentives for BOT companies to cover their cost and to get benefits. Those companies can purchase the machines and equipment from abroad without tax exemption. Required procurements can be purchased with the local price. After the construction period (grace period), they can collect the toll payment and they have to pay the restricted percentage to government and they can return revenue and get their profits.

BOT companies are allowed to participate in road development so government can release the heavy burden and can try to fulfil in other required sectors with acceleration. BOT road construction projects cannot be implemented in some places with low traffic volume because the companies cannot return their investment. As there are low traffic volume in border areas, it is needed to consider how to develop the road construction. Road projects in those areas are now being implemented with government budget. Road construction projects are essential for not only in the urban but also in the rural and border areas. As the projects can be implemented faster and faster and better and better, transportation sector advances speedily. Commodities and goods will flow smoothly and quickly. People can suffer the social and economic benefits.

## **2. LITERATURE REVIEW**

In Myanmar, PPP projects are important for country's development as government cannot support the public services especially in transportation sector because of the huge amount of the investment. On the other hand, private sectors have chances to invest in public services and share the risks in those projects. In this Chapter, the definition of PPP and applications is given. PPP with BOT based road construction is the promotion of the transportation sector in country by private investment. (Chen and Subprasom, 2007).

### **2.1. Definition of Public Private Partnership (PPP) in general and its Applications**

Nowadays, PPP is defined as "an approach to introducing private management into public services by means of a long term contractual bond between an operator and a public authority."(UN/ECE Forum, 2000).

PPP is also defined as "a mutual beneficial collaboration between public and private sectors, built on the expertise of each, in developing a country's (public goods) infrastructure, through the appropriate allocation of resources, risks and rewards."(JICA, 2000).

Although different researchers define the term PPP in different ways, the basic definition is the same because it is partnership between public and private sector in partially or all public projects. PPPs are partnership between public and private sector in public owned utilities (such as: transportation, water, electricity, health, information, sport, telecommunication

and other infrastructural asset) with private's investment.(Grossman.,2008). PPPs are popular to carry out the infrastructure projects both in developed countries and in developing countries in the whole world. There are budget constraints (Khan et.al,2008) in most of developing countries to carry out development projects. That's why, technological, methodological, funding resources from private sectors are used for public projects. (Bansal, 2012)

The use of PPP is increasing to involve the private sector in public services. Private capitals and expertise are important in the operation of public services .There are heavy and increasing cost of maintenance, operation and renewal in infrastructure projects. PPPs are long term projects and effective cooperation or partnership between public and private sector to invest private's financial in public projects. PPP projects take 20 years to 30 years (eg: Southern Tagalog Arterial Road –STAR 30 years)(Vietnam), some 45 years (eg; Myanmar BOT roads projects)and in some projects 75 years (eg; Indiana Toll Road -ITR)(US) and the Chicago Skyway was leased for 99 years. So, we can learn that PPPs are long term projects depending on investment and costs as well as partnerships.

PPP modalities are different due to the concession periods, contract agreements, project investments and partnership between public and private. (Handley .P, 1997) mentioned that there are various kinds of partnerships in BOT format: BOOT, BTO, BOO. JICA (2010) mentioned different PPP modalities as follows: BO, BOT, BT, BLT, DB, DBM, MC and etc.

Rules and regulations and practicing systems in PPP projects are not the same according to the respective countries. In PPP projects, public and private partners are sharing risks with private investments in public projects. The main aims and objectives of public and private partners may not be the same. One of their intentions is to develop the infrastructure projects which requires a lot of budgets and government alone cannot solve that problem. Actually, those projects are really essential to support for people and country's development.

PPP is used as a tool to deliver infrastructure (Siemaitycki, 2011) in the developed countries and developing countries for different methods and different purposes. In the United Kingdom, government has encouraged the infrastructure development through Private Finance Initiative (PFI) since 1992 (H.M treasury, 2012).A single concessionaire has a contract in which design, building, financing, operation and maintenance facilities are included. Smyth and Edkin (2007) viewed that PPP is a long term lasting from 25 years to 99 years to pay annual fees in return which is sufficient to cover cost, maintenance operation expenses and a margin of profits. PFI policy depended on private rather than public bureaucracy.UK PPPs are performance –based than demand –based approach.PF2 model was launched as a new approach to P3 and a revised guidelines document “Standardization of PF2 Contract” on 5<sup>th</sup> December, 2012. (Buisson, 2013).

In Hong Kong, Private Sector Involvement (PSI) has initiated BOT project , 1967Cross Harbor Tunnel with 30 years contract since 1967 .Being successful and safe and reliable projects, land road tunnels such as Tate's Cairn Tunnel in 1988,Western Harbor Crossing in 1993,the Route 3 Country Park Section,1995 were started with BOT basis.(Mak,2015).Design, length ,capacity, traffic demand, construction time, construction cost are different but concession periods are the same.(Zhang,2009).

In the Philippines, PPP road construction are based on BOT model and appropriate concession periods are determined on the basis of the impact of risks on cost, revenue, profit of PPP projects under different internal rate of return(IRR)(Ng et al,2007).Examples are Southern Tagalog Arterial Road(STAR) with 30 years contract from 2000 to 2029 and Tarlac-Pangasinan-La Union Expressway (TPLEX) with 35 years contract from 2008 to 2043.National Economic of Development Authority(NEDA) decided the different concession period depending on the traffic volume and toll fees. Private sector participation including FDI in infrastructure development in Vietnam is based on the BOT, BTO and BT and established in 1997.(Ashurstinsight,2012).

In Malaysia, PPP road construction projects between 1985 -1997 are BOT models with 25 concession period.(PwC,2012).Th famous BOT road construction is North-South Expressway (NSE), a 772-km expressway extending from the border of Thailand in the north to the border of Singapore in the south , completed in 1988, 15 months ahead of schedule and was fully operational by February 1994.(PwC,2012).

PPPs are operationalized in infrastructure development of respective countries to support the country's development. Qiao et al(2001) mentioned eight success factors for BOT projects of China: appropriate project identification, stable political and economic situation, attractive financial package, acceptable toll /tariff level, reasonable risks allocation, selection of suitable subcontractors, management control and technology transfer. Kumaraswamy and Zhang (2001) stated that win-win principles, adequate legal and regulatory framework, stable political environment, good state credibility, developing domestic capital market, competitive bidding, handling land acquisition, option of government grantees, feasible project and strong sponsor are key success factors for PPP. Zhang (2005) mentioned five success factors for PPPs: economic viability evaluation, appropriate risks allocations, reliable concessionaire consortium, favorable investment environment and sound financial package. Li et al (2005) identified for five UK's KSF for PPP as effective procurement, project implementability, government grantee, favorable economic conditions and available financial market. Chan et al (2010) pointed out the China's KSF for sPPP: macroeconomic environment, shared responsibilities between private and public sector, transparent and efficient procurement process, stable political and social environment and judicious government control. By means of the objectives, cost, time and quality, the success or failure of the projects can be measured (Agrawal, 2010). Agyemang (2011) identified five success factors as resource save, traditional key performance indicators': cost, time and money, public satisfaction, value for money achieved and risks management. Hwang et al. (2013) found out success factors for Singapore's PPP: well- organized public agency, appropriate risks allocations and sharing and strong private consortium are the most success factors. It is needed to examine the Myanmar's success factors in PPP road construction to attract the local and foreign investors.

In Asian countries, privatization of infrastructure started in the mid-1980s to overcome the economic growth. State- owned enterprises were privatized in various ways. This option was popular in South –East Asia nations. In 1987, economic boom started and there were huge demand of resources to increase the economic expansion. Governments needed improvement of infrastructure in Asia. (Handley, 1997)

## **2.2. PPP in Myanmar**

Myanmar government is trying to increase the private sector participation (PSP) to develop the economic infrastructure (eg. road, power generation and distribution,

telecommunications, sanitation and water supply and so on) as public private investment is really essential for the infrastructure development in a country. To attract the private sector, government intends to help them to overcome their challenges of obtaining the finance to implement the projects successfully. Government liberalized the tax, deposit capitals and interest rate. PPP was introduced in 1996 in military government time. Potential areas for PPP in Myanmar are transportation, electricity, education, telecommunication, energy and health sectors. Now, 28 local private companies have been participating in 63 road construction projects with BOT system but international private companies have not participated in those road projects yet. Enhancing PSP in the public projects is one of vital issues for Myanmar's development. It is good opportunity for investors to implement PPPs according to the FDI law (2013) because there is not specific PPP law in Myanmar.

### **2.3. Transportation System in Myanmar**

Myanmar is the second largest country in South East Asia with the total land area of 677,000 square kilometers. It stretches for 936 kilometers from East to West and 2051 kilometers from North to South. Myanmar is bordered with its neighboring countries for about 6151 kilometers, sharing 2205 kilometers with China, 2108 kilometers with Thailand, 1339 kilometers with India, 274 kilometers with Bangladesh and 225 kilometers with Laos. The length of the coastal line from the mouth of Naaf River to Kawthaung in Taninthary Region is 2229 kilometers. The population of Myanmar is 59.8 in 2014. There are 135 national races living in seven States and seven Regions. Myanmar is situated in South East Asia and it has a total length 2832 km of castling and shares borders with China to the northeast Laos Thailand to the southeast, Bangladesh and India to the west and northwest. The Gulf of Martaban and the Bay of Bengal lie in the south and southwest of Myanmar. It is one of the largest Asian mainland countries located east of India and South of China. Because of the location and land situation, air transport, inland water, road and railway are used as the transportation system.

There are three main responsible Ministries for transportation sector: Ministry of Transport, Ministry of Rail Transportation and Ministry of construction. Myanmar air transportation saves the time but the most expensive among all the transportation system. Inland water way is widely and mostly used in Delta Regions but it is not safe in rainy season. MoC promotes the road network by constructing roads and bridges to communicate and transport easily. Travelling by the bus is more expensive than travelling by trains and by using inland waterways. Inland roads are mostly used in Myanmar transportation sector. There is low motorization rate, about 83.854319 vehicles per 1000 population in Myanmar. Road density by population is 0.0031709 and road density by areas is 0.2408968. (MoC, 2014).

### **2.4. Road Situation in Myanmar**

Under British colonist (1885-1948), roads were constructed by Highway Department. Under Socialism (1962-1988). Government obviously practiced the close door economy. After 1988, SLORC announced an open market-oriented system. Specifically, the reforms aimed at increasing the outward orientation of the economy and its integration with the world economy and expanding the role of private enterprise. The United States, the European Union, and Canada have imposed financial and economic sanctions on Myanmar which affected the country's development.

After an election in November 2010, new government took initial steps toward reforming and opening up the economy by lowering export taxes, easing restrictions on its financial sector, and reaching out to international organizations for assistance. After years of diplomatic isolation and economic and military sanctions, the United States relaxed curbs on foreign aid to Myanmar in November 2011 and announced the resumption of diplomatic relations on 13 January 2012. Government has worked closely with local and international experts and international agencies in order to find solutions to the perennial problems of the national economy. New government laid down MCDV and NCDP for the country's development. Foreign investment is important for the infrastructure development requiring the financial assistance as well as the technical assistance activities. FDI Law was announced in 2012 (issued in 2013) to enhance private sector participation both local and abroad. According to Myanmar history, political, economic and social sectors are mutually related to one another.

As Myanmar is a member of UN, ASEAN, BINSTEC, GMS, etc., the new government transforms the open market economics system so infrastructure development is the vital role in the country. It is very important for the transport related activities in Myanmar toward achieving a harmonized, coordinated and integrated regional transport system through broad based strategy. Roads are important for regional and international for communication as well as for the trade (Swe., 2009).

According to the geographical situation, implementation of road connectivity is also important for economic growth in Myanmar, existing roads are needed to upgrade and the new roads need to be constructed for infrastructure development. Government laid down the 30 years Road Development Plan from 2001 to 2031 with six -five year plan. (MoC, 2013). ASEAN Highways are still needed to be constructed because Government's budget is not enough to construct the new roads. Government needs the private sector (both local and abroad) participation in road construction.

According to the geographical situation, road connectivity is very important for the smooth transportation and communications both in the urban and rural areas. There are 36 road links from East to West and 45 road links from North to South. Myanmar roads have been constructed by the government's fund since the ancient time. Private sector started to participate in road construction in 1996. PW of MoC is the key responsible Department for construction, administration and maintenance of Highways and international Highways.

Since 1996, MoC introduced PPPs projects as BOT based system in Myandalay-Lasio-Nankham Road with the length of 480 km, partnership between PW and local companies, Asia World Company and Diamond Palace Company. Contract period for BOT companies is 45 years from the start of operating period until the end of transfer periods. The process in attaining the BOT projects are as follows:

First of all, the company which wants to work in road construction must submit the proposal to PW with the capability assessment based on the 24 facts of policy or regulations laid down for BOT proposed company. The cash flow, profits and loss, recoupment period and IRR must be included in the proposal. The submitted proposal is assessed and approved by PW. PW submits proposal to get the approval by the Executive Committee (EC) of MoC for initiating the construction. If EC doesn't agree the proposal, the company must propose again with new estimated proposal. After that, PW (now RD) send to the Chief Lawyer Office to get the acceptance. After getting acceptance of the Chief Lawyer Office, RD

continues to submit the proposal with the Chief Lawyer Office's acceptance to Myanmar Investment Commission (MIC). When the BOT road construction proposal is assured by MIC, the company can sign the contract with RD. And then, that company starts to operate the construction according to the upgrading standards.

In Myanmar, BOT roads projects are not new road construction projects. They are upgrading the existing roads. There is not specific BOT law in Myanmar but Highway Act, 2000 edition, is still being used for BOT road as the standard law in MoC. BOT road companies must also follow the 24 facts laid down and the policy of ASEAN road standard of transport system. The model of BOT schedule is not the same as other countries. Myanmar practices its own procedures and regulation due to the current situation. Myanmar government is trying to solve the problem of budget in these major projects by looking for the loan, grant aids and assistance from abroad.

### First BOT Project in Myanmar

	Lasho- Muse Section(Shan State)
Input	-Oriental Highway Company started to propose the project to the Government -45years projects
Process	--project from 22-7-1996 to 21-7-2041 -22-7-1996 to 21-7-1999(grace years) -22-7-1999 to 21-7-2009- 5% -22-7-2009 to 21-7-2019- 10% -22-7-2019 to 21-7-2029- 15% -22-7-2029 to 31-7-2041- 20% -investment-982 million kyats -risk management for most concerning risks- 45 years long term risks, market risks, sovereign risk(changed to democracy government), technology risks, procurement risk, financial risk(Chung & Hensher,2015)
Output	-Company gain- 2480002690ks (90%) -Government gain-591111410 ks (10%) (2013-2014)
Outcome	The development of hotel & motels appendix(1), education appendix(2)
Impact	Trade Volume of China appendix(3), growth of GDP appendix(4), and accidents are shown in appendix(5)

### 3. METHODOLOGY

PPPs are the long term projects and partnership between public and private sector for the purpose of doing business. Those projects are indeed operated to fulfil the citizens' needs and demand of their own countries and by doing those projects, the partner can get the benefits.

There is the concept in PPP that is the long term license given to the private sector to deliver the public service for profit (Cartlidge , 2006).As PPPs are long term projects with

large amount of investment , there may have success or failure of the projects. Design, construction, finance, facilities management and service must be carefully and systematically controlled and managed by both sides. With the collaboration and cooperation one another, PPPs will be successful ones. Indeed, PPPs are the projects of risks transfer from the public to the private. Government, government agency or ministry, project company, investors, lenders, contractor, operator and supplier are key actors in BOT projects. Myanmar BOT model is somewhat different from other countries like other ASEAN countries and European countries. Most of Myanmar BOT roads are not newly built but they are existing roads to be upgraded according to the agreement and the AADT.

Qualitative method is used to learn the observation, actions and interactions of individuals or organizations in society (Scott and Garner, 2013). Berg and Lune (2014) mentioned qualitative research as “the meanings, concepts, definitions, characteristics, metaphor, symbols and description of things”. Researcher can explain the social phenomena from the inside in different ways as follows: by analyzing experiences of individuals or groups, by analyzing interactions and communications in the making and by analyzing documents or similar traces of experiences or interactions (Flick, 2007). Sub- research questions are asked to be appropriate to achieve the purpose of the research and feasible for the study in term of the resources of the researcher. Data collection and generation can be done through audio- visual recording, documents, surveys, observations and note taking. Face- to- face interview, group interviews can be done. Ethics issues and universal ethical principles such as: honesty, justice and respect are followed up. (Miller, et.al. 2012)

Primary data and secondary data are collected to analyze and achieve the outcome of the research with senior engineers from MoC, and OHC. Interviews take about an hour. Secondary data are collected through the other researchers’ papers, records, reports of the concerned ministries, BOT road construction companies, articles from journals, magazines and through the websites, etc.

With the researcher’s careful attention and systematic practice, quality in process and careful application in the study can provide the research outcomes or findings. The validity of the research concerns the interpretation of the observation and truth worthy results presented to the audience. Researcher’s interpretation, conclusion and findings will be shared to the participants and their feedback are accepted.

## **4. FINDINGS AND DISCUSSION**

### **4.1. Findings**

As this paper focuses on the qualitative method, samples or target people or interviewees are responsible personnel from MoC and the engineer and the manager OHC (AWC). Government officials were interviewed at the office of Deputy Director General (DDG) of RD, MoC on 7<sup>th</sup> September, 2015. Interviewees from Oriental Highway Company (OHC) were interviewed at their office at Naypyitaw. Most of the Interviewees are civil engineers and are still working MoC and in BOT road construction projects. All were willing to answer the questions and shared their own experience. OHC (AWC) has contracted with PW (now reformed as RD) with the contract agreement no. PW/AW/96-97/MLM/TR-01 on 22<sup>nd</sup> July, 1996 to implement Muse- Lasho section (100 miles 3 furlongs) with 30 years contract period. Due to the contract of 1st October, 2010, company can implement that



project from 30 years contract period to 40 years contract period. Now, OHC has been working the total road length 643 miles in different parts of Myanmar, including Mandalay - Lasho- Muse section. OHC has experienced for more than 19 years in BOT project.

Nowadays, road transportation is the most important in inland transportation infrastructure in Myanmar. Interviewee from MoC explained, "...Every country needs strong infrastructure development for the country's political, social and economic development. Among different kinds of infrastructure sector, transportation infrastructure must be developed for country's continuous political, social and economic development. Under transportation infrastructure, road, bridge infrastructure is the most important ..." and "In transport mode, there are three main modes: land, water and air. Under land mode, there are two modes: railways and motorways. All the modes in transport sector are important. Among them, motorway is widely and mostly used in Myanmar current situation". (Words of DDG from MoC mentioned at interview on 7<sup>th</sup> September, 2015).

PPPs are projects coordinated by public and private. So, private can learn technology from public and also public side can fulfil for the people's needs with the private's investment. Project engineer of OHC shared his knowledge, "PPPs are the projects implemented by local/ foreign investors with limited periods. After finishing the agreement, we must hand over those projects to government. That's why, government owns them again and does not lose the ownership. It is needed to share the certain ratio of risks sharing with the government and the private". (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015)

BOT road projects in Myanmar are projects to implement and upgrade the existing roads due to the increasing AADT. According to the interviewee, BOT projects were started on Mandalay - Lasho- Muse section and continued in the whole country. One interviewee explained that in 2000, government invited seven companies to join and work on Yangon – Mandalay Union Highways with BOT system like Northern part of Shan.

BOT project companies can implement good road condition. As a result, people feel better and can easily travel their destination in the region. Toll manager shared his own experience that it took half day from Theinni to Lasho (30 miles). The road was so bad if one car was broken down, they had to wait it and slept on the way because they could not pass that car. After company has constructed as the BOT project, people could go within one and half hour if the speed higher, they could get faster. They went for Theinni to Lasho for half days before but at present situation, they could travel round trip from Lasho to Mandalay. (Words of Toll manager of OHC at interview on 14<sup>th</sup> September, 2015).

One interviewee supported that BOT road were developed more, and transportation became better than before. He said "You could hear that the road in Nyaunglaybin Part or Phew Part were not good enough to travel and passed through the damaged road. By giving the chance to work the BOT companies with their own budget, the road became better. New generations do not know that previous situation of road in their native town."(Words of DD from MoC mentioned at interview on 7<sup>th</sup> September, 2015).

Project engineer said, "Good road and smooth transportation is important in Myanmar. If the roads are not good enough to travel, people cannot communicate and commerce with other regions easily and our people's economy, social condition, education, health and every sector will be slow down." and " As private sector is participating to invest

their own money in road construction projects, government funding can invest in other required projects. As the roads become better, people can travel everywhere easily and can do their business more and their products can be imported to the target in time and quickly”. It is noted that private sector participation in public service is good opportunity for both sides. (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015).

Private investors can do their projects as quickly as they can to get local people’s satisfaction. Even the streets vender said that they could see the urgent maintenance for even a hole in the road as soon as possible and once, he had not had such experience before. He was satisfied with the quick action of BOT project. Company could do the maintenance as soon as they knew. (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015).

BOT companies are needed to learn new technology which will save the time and cost in their projects. “We constructed with the traditional method before but now, we are using new method by mixture of the earth and cement (cement stabilized) as the based-course in Northern Shan State with the permission of MoC. It was a little bit faster than before and we overlaid the AC with the required machinery and with the laboratory in that region. And then it reduced the cost and time because of the new tech.” explained proudly for their success. (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015).

“...the more BOT road are developed, the better the transportation becomes. If the transportation becomes better, people’s satisfaction is the first one. We don’t need even to calculate the GDP but they are happy to go their destination quickly and safely. We can share their happiness. As the road sector is developing, the transportation sector also develops. Land users are more and more because of the smooth communication so transport infrastructure sector is also improving.” said by one interviewee. (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015).

It is noted that Myanmar government restricted toll collection fee rates so BOT companies were not allowed to collect over toll fee. Toll manager explained that according to MoC’s policy and guidelines, they could not collect the extra toll fee. If not so, they would be punished. Sometimes, company did not collect the toll fee and allowed them to use road freely. Toll manager said that they did not collect fee in local people’s social affairs. They ever gave free-of-charge for the motorcycles, bicycles, trishaws and horse- carriage of the local people. Free lane could be used for social welfares (For example: for going to the cemetery), religious affairs (For example: Novice Ceremony, 20-30 cars were free), military vehicles and other restricted free cards. (Words of Toll manager of OHC at interview on 14<sup>th</sup> September, 2015)

Due to the restricted toll fee rates, some BOT companies returned less income they expected. He said that they could not invest new technology / method and machineries introduced by international companies because of current income from toll fee was not enough to buy these materials. (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015)

As BOT projects are JV projects, Myanmar government supported the private in some technical assistance. “We are welcome and government supports the technical assistance every time and everywhere” said by Site- engineer (Words of Site- engineer of OHC at interview on 14<sup>th</sup> September, 2015)

Nowadays, Myanmar BOT are suitable for the country's development. Project engineer agreed in his answer, "According to my experience, these projects are suitable for the country's development but we must follow the contract agreement in doing the project." (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015)

A country's development is connected with the road development. DDG said, "... country's economy will not be improved if she stays alone. There are international road links to connect with one country to another. When these road links are connected each other, the economy of those countries will be improved." (Words of DDG from MoC at interview on 7<sup>th</sup> September, 2015).

CE from MoC proved that MoC has constructed Myanmar roads with government's budget and attracted private to participate in those projects. He said, "In Socialist time, MoC, SEE, was responsible agency to construct the roads in Myanmar with government's budget but none of private sector participated to invest in road construction. In 1996, private companies started to join in road construction with PPP system." and "Very beginning, private sectors were to participate in road construction not because of their will but because of invitation to participate in those PPP projects (eg: Mandalay- Muse Road). But now the local companies want to apply the BOT projects by their own desire." (Words of CE from MoC at interview on 7<sup>th</sup> September, 2015).

"BOT road construction projects are very supportive for the country development." explained by Project engineer from OHC at interview on 14<sup>th</sup> September, 2015.

Although local investors desire to invest in projects, they are waiting and learning government's support. Chief engineer from RD said, "Most of them are interested in those projects as they know that as the transportation is developing, economic and other sectors will become to develop. They know and learn from other countries' experience that profit can be got from the project. But they wonder whether they can get return for their investment or whether government subsidizes if they face the failure. They are hesitating to invest in PPP but they are interested in the projects." (Words of CE from MoC at interview on 7<sup>th</sup> September, 2015).

Myanmar BOT projects are still in processing period but they do not have enough required technology, HR and machines for successful projects. DDG from MoC mentioned in his answer, "From the beginning to till now, among 28 companies, only two or three companies have road design section with enough engineers. For example, Oriental Highway, Shwe-taung Company, and Max Highway." (Words of CE from MoC at interview on 7<sup>th</sup> September, 2015).

If Myanmar BOT regulations are upgraded if more local and foreign investors can be attracted. "We must have strong BOT rules and regulations. International JV companies start to learn the system of toll fee. The rate of toll fee is less many times than in other neighboring countries. When they are calculating the IRR value, it is impossible to invest in that road. So, they withdrew investment in the PPP projects in Myanmar." said CE from MoC at interview on 7<sup>th</sup> September, 2015." (Words of CE from MoC at interview on 7<sup>th</sup> September, 2015).

Foreign companies are interested in Myanmar BOT projects to invest as JV more. DDG from MoC said, “All the investors are needed to participate in the projects. Some foreign investors came to study our policy, regulation, and grantee. They want to invest here and JV especially Chinese companies.”(Words of DDG from MoC at interview on 7<sup>th</sup> September, 2015).

Private sector is willingly to increase more BOT companies in Myanmar and Project engineer openly said and expected, “If the local or foreign investment in BOT projects increases, every sector and political, economic and social standard will be developed. People’s economy and social conditions will be improved. There will be better transportation system, better infrastructure and technology will become higher. It is a chance to find more careers for local people.” (Words of Project engineer of OHC at interview on 14<sup>th</sup> September, 2015)

Myanmar government required to lay down the reliable PPP law with international standard to increase investors in PPP projects. “..... we must have the laws/policy/rights to protect the local investors but the laws must be fare and flexible for both sides. We need to know international practice. We must have the sound foreign investment law including with the suitable restricted percentage of local investment....” said DD from MoC at interview on 7<sup>th</sup> September, 2015.

## **4.2. Discussion**

According to interviews with public and private side, the research questions can be answered as follows:

Q1: “To what extent can PPP projects with BOT road construction in Myanmar enhance the Country’s development?”

PPP projects with BOT road construction are required to implement more and more in Myanmar. They can actually enhance the transportation infrastructure which really supports to develop country’s economy and social standard directly. Although foreign investors are keenly interested in PPP projects, they have not invested till now due to lack of strong PPP law. In spite of most of local investors cannot invest a large amount of money, enough technology and human sources, they are trying to do those projects as much as they can for their country’s development.

Q2: What are the key success factors (KSF) of BOT road construction in Myanmar?

According to interviews, most of KSF are similar on both sides and different ideas can be learnt interestingly as follows:

### Similarities and differences of KFS

No.	MoC	OHC
	<b>Similarities</b>	
1.	-Strong PPP Law	PPP Law
2.	-Strong Investment	-Capitals(if Private company needs money, public bank lend with low interest)
	-Clear policy guidelines	-Policy maker and their agreement
	-Fare and flexible investment law	-Appropriate, fixed and strong Laws for investment
	-Cost, time, money and safety	time, money, security and safety
	- Competition	- Competition
	-Good procurement systems	-Good procurement systems
	-Sharing more awareness of BOT system and toll collection to Local People ( traffic users and local businessmen)	-Sharing more awareness of BOT system and toll collection to Local People ( traffic users and local businessmen)
	-International companies' investment in technology, money, etc	-International companies' investment in technology, money, etc
	- Development of Banks and banking systems	-Sound and strong Banking system
	-Government's subsidies	-Government's subsidies
	-HR Management and HR development trainings	-HR Management and HR development trainings
	-Systematic toll collection rate	- Appropriate rate of toll collection fee
	<b>Differences</b>	
	-Stability of political situation	-People's satisfactory
	-Government grantee	-Good management and experience
	-Government's systematic risk sharing	-Method , material and money
	- Strong Tax Policy	-Well-organized Company
	-Private companies' interest	- Sound management before disaster affected projects
	-Forming concessionaire consortium group freely	

Q3. How do local/ foreign investors of BOT road construction projects play an essential role to support Myanmar's development?

According to the current situation, Myanmar needs to develop her road network to connect locally and internationally. The roads must be upgraded and implemented due to the international standards to be better connectivity and to narrow differences between the rural and urban development. Government's budget is not enough to fulfill public needs. When more and more local/ foreign investors of BOT road construction projects join these projects, infrastructure development will be improved to support country's politics, economy and social condition. In other words, they play an essential role to support the country's development partially or completely.

### **4.3. Results of the Research**

Findings from the research, the fruitful outcomes of the research are mentioned as follows:

Myanmar BOT road construction projects started in 1996 and mostly started around 2000 with 45 years long term contract. Some are still in initial stage of construction. Some are in upgrading stage .Some are doing in maintenance stage. Some companies are finding shortage of investment to continue the project implementation. Some gave up the projects to the government. The reasons are (1) high investment (2) Government's fixed toll collection fee (3) low income in some places (4) free -of-charge (5) not enough technology and (6) lack of experience. Concession length needs to match each project and make ensure a balance between private sector returns and public sector control. With current low traffic volumes and limited ability to pay the tax to the Government, PPPs investors are difficult for full cost recovery from toll payment. The timeframe of concessions should be carefully examined when government prepares the bid documents and concession agreement.

Some BOT companies are facing the difficulties in finding new engineers since they have to work on the roads and to control the road maintenance all the time. The responsible project engineers are working more than their effort. Some companies do not have enough technology, facilities and human resources implementing the projects. Some cannot implement the projects efficiently although government contributes such as road design, closed supervision and human resource development trainings and management. So, strong and well-organized BOT consortium groups must be formed to compete with each other.

Lack of respective PPP law and strict BOT law/rule and regulations, companies have encountered in discussing with the local people/local authority for land -use when they upgrade the roads. Local authority and responsible agencies should negotiate with the regional people to solve these problems. If not, the projects cannot finish within the targeted time frame. Strong legal framework such as: FDI law, flexible Tax Law should be revised according to the international standard to attract more foreign investors.

Systematic procurements system are not used in both public and private sides. Systematic project management with international standard are required for successful projects. Myanmar government tries to form the confirmed PPP regulatory body which can give the specific guidelines and rules and regulations. It is still in processing stage. Efficient and strict rules and regulations for the PPPs projects are required. To become successful projects, PPP awareness should be delivered widely to private companies and public (land – users, drivers, local business, etc.)

## **5. CONCLUSION, RECOMMENDATIONS AND LIMITATIONS**

### **5.1. Conclusion**

BOT projects are important partnership between public and private sector in Myanmar. They are different from other countries' practices because Myanmar government laid down her own rules and regulations. Myanmar should revise the laws with the international standard to promote the local and foreign investors. That's why, PPP regulatory body should be formed for the reliable management and evaluation of PPP projects. It is important that Myanmar banking system must be improved and the domestic and

international banks investors must be invited. They can assist BOT companies as they require capitals to implement the project successfully. Government should attract the people to save in the banks more and more. Government should allow the consortium groups to invest in BOT projects. Government should distribute BOT projects awareness to road users and local people who are key persons for successful projects. So, with the collaborations and mutual understanding of citizens, government (public) and private, PPP projects can increase more. Being a developing country, Myanmar should promote private sector participation in public services by evaluating the current procedures and practices to get win-win situation.

## **5.2. Recommendation and Limitation**

Results of interviews with public sector (MoC) and private sector (OHC) are mentioned in this research. All interviewees answered in Myanmar language to explain clearly and effectively. Both sides are not allowed to take audio-video conferencing. Face- to face interviews were done in their office for their safety and security. Data were collected with the researcher's careful attention and systematic practice of note taking and careful application through the observations. Interviews were done at different places in different time with different people. Researcher's interpretation, conclusion and findings will be shared to the participants and their feedback are accepted. Qualitative research takes time. Due to the time limitation, more detailed questions should be asked to get specific answers. This paper can be used for the researchers who study Myanmar BOT system and its KFS. This paper can support the researchers who continue to do further detailed analysis on PPP. This paper can assist Myanmar government and BOT road construction companies to implement their projects successfully.

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## APPENDICES

### Appendix 1: The development of hotels and motels

S.N	Particulars	1992			1993			1994			1995		
		No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds
1	State- owned												
	Shan State	6	171	342	6	181	362	6	181	362	6	181	362
2	Private- owned												
	Shan State	1	11	26	9	238	530	13	204	n.a	13	170	340

S.N	Particulars	1996			1997			1998			1999		
		No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds
1	State- owned												
	Shan State	8	394	788	8	394	788	8	400	800	8	400	800
2	Private- owned												
	Shan State	79	1403	2806	79	1403	2806	79	1479	2958	85	1616	3232

S.N	Particulars	2000			2001			2002			2003		
		No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds
1	State- owned												
	Shan State	6	360	720	8	444	888	101	2237	4474	101	2237	4474
2	Private- owned												
	Shan State	87	1709	3418	101	2237	4474	101	2444	4888	105	2516	5032

S.N	Particulars	2004			2005			2006			2007		
		No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds
1	State- owned												
	Shan State	1	108	216	1	108	216	1	108	216	1	108	216
2	Private- owned												
	Shan State	118	3058	6116	120	3172	6344	121	3219	6438	124	3336	6672

S.N	Particulars	2008			2009			2010			2011		
		No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds
1	State- owned												
	Shan State	1	108	216	1	108	216	3	121	242	2	115	230
2	Private- owned												
	Shan State	123	3277	6554	130	3480	6960	128	3263	6526	134	3515	7030

S.N	Particulars	2012			2013			2014		
		No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds	No. of hotels and inns	No. of room	No. of beds
1	State- owned									
	Shan State	2	115	230	5	266	532	5	266	532
2	Private- owned									
	Shan State	149	4422	8844	172	5094	10188	341	14598	29196

## Appendix 2: Development of Schools, teachers and students

S.N	States and Region	Year	Schools			Teachers			Students		
			High	Middle	Primary	High	Middle	Primary	High	Middle	Primary
1	Shan	1995	76	200	4116	966	3255	13115	21354	88190	403459
	State	1996	89	204	4141	1007	3366	13111	23175	100495	399435
		1997	90	202	4179	996	3351	13338	24147	102872	411631
		1998	90	202	4179	1028	3333	12539	23862	105158	395645
		1999	94	208	4197	1027	3697	13123	34588	107893	379283
		2000	98	209	4213	1082	3238	11638	35047	116575	391058
		2001	100	208	4216	1132	3367	11767	33970	123406	403377
		2002	112	206	4199	1302	3465	11404	36917	121662	441958
		2003	115	1239	35458(r)	206	3533	133001(r)	4208	12736	422617(r)
		2004	4254	15221	450612	210	3930	148079	122	1406	40755
		2005	4244	16014	448220	216	4602	152669	134	1561	43515
		2006	4241	16287	457038	216	4531	168028	134	1603	45985
		2007	4236	16507	464357	216	4753	167029	135	1785	43659
		2008	4179	17001	461277	217	4470	168762	135	1865	44754
		2009	4184	16867	470219	217	4471	177379	135	1837	45619
		2010	4180	16263	475000	217	5132	180088	139	1879	47274
		2011	4168	17309	466347	219	4586	180104	151	1985	46840
		2012	4177	16537	471626	212	5363	185933	164	2247	46464
		2013	4216	16799	485410	207	5268	193726	172	2220	47891
		2014	4799	16126	514641	313	5202	207703	288	2408	51641

**Appendix 3: Positive impact Accidents****Trade Volume of China (1988-2010)**

US\$ Million

<b>S N</b>	<b>Year</b>	<b>Export</b>	<b>Import</b>	<b>Total Trade Volume</b>
1	1987 - 1988	23.45	3.75	27.20
2	1988 - 1989	145.68	143.61	289.29
3	1989 - 1990	123.39	79.81	203.20
4	1990 - 1991	64.02	194.73	258.75
5	1991 - 1992	70.02	142.97	212.99
6	1992 - 1993	56.81	158.71	215.52
7	1993 - 1994	34.44	206.79	241.23
8	1994 - 1995	47.11	173.07	220.18
9	1995 - 1996	34.91	256.5	291.41
10	1996 - 1997	50.04	189.25	239.29
11	1997 - 1998	102.73	245.08	347.81
12	1998 - 1999	91.44	279.54	370.98
13	1999 - 2000	135.74	251.31	387.05
14	2000 - 2001	176.18	285.85	462.03
15	2001 - 2002	229.59	307.3	536.89
16	2002 - 2003	471.66	360.9	832.56
17	2003 - 2004	224.25	470.24	694.49
18	2004 - 2005	291.01	494.55	785.56
19	2005 - 2006	332.03	501.6	833.63
20	2006 - 2007	571.23	730.63	1301.86
21	2007 - 2008	697.68	994.99	1692.67
22	2008 - 2009	617.72	1208.09	1825.81
23	2009 - 2010	634.97	1258.09	1893.06

**Appendix 4: Positive impact Accidents****GDP in Shan State**

No.	Budget Year	GDP(kyats million)	GR (%)
(At 2000/2001 Constant Prices)			
1.	2000-2001	167323.6	
2.	2001-2002	193002.2	15.3
3.	2002-2003	226142.5	17.2
4.	2003-2004	266617.4	17.9
5.	2004-2005	312726.6	17.3
6.	2005-2006	357965.1	14.5
(At 2005/2006 Constant Prices)			
10.	2006-2007	1058336.9	12.0
11.	2007-2008	1185757.4	12.0
12.	2008-2009	1271357.7	7.2
13.	2009-2010	1390145.9	9.3
14.	2010-2011	1518168.1	9.2
(At 2010/2011 Constant Prices)			
15.	2011-2012	3016919.4	2.4
16.	2012-2013	3130563.7	3.8
17.	2013-2014	3273012.5	4.6
18.	2014-2015	3449923.4	5.4

**Appendix 5: Negative impact Accidents**

S.N	Particulars	Year	Causes of accidents					Total
			Motor Vehicles	Motor Vehicles and Slow Moving Vehicles	Motor Vehicles and Pedestrians	Motor Vehicles and Animals	Motor Vehicles and Others	
1.	Shan State	1998	127	37	152	1	197	514
		1999	149	59	144	-	171	523
		2000	192	78	189	1	185	645
		2001	146	81	154	-	176	557
		2002	142	79	135	-	219	575
		2003	197	38	177	4	162	578
		2004	99	32	124	-	319	574
		2005	223	38	118	-	157	536
		2006	234	29	114	1	198	576
		2007	261	31	117	-	258	667
		2008	155	52	72	1	327	607
		2009	491	5	129	-	28	653
		2010	73	7	123	-	574	777
		2011	273	23	133	-	529	958
		2012	701	64	145	2	194	1106
		2013	774	69	116	1	180	1140
		2014						

## ACRONAMS

ADB	-Asia Development Bank
ASEAN	- Association of South East Asian Nations
BINSTEK	- Bay of Bengal Initiative for Multi-Sectoral and Economic Cooperation
BOO	- Build-Own-Operate
BOT	- Build Operate Transfer scheme
BOOT	- Build, Own, Operate, Transfer
BLT	- Build- Lease-Transfer
BT	- Build-Transfer
BTO	- Build-Transfer-Operate
CE	-Chief Engineer
DB	-Design-Build
DBFO	- Design, Build, Finance and Operate
DBM	-Design-Build-Management
DCMO	-Design, Construct, Maintain and Finance
DD	-Deputy Director
DDG	- Deputy Director General
GMS	- Greater Mekong Sub-region
JICA	-Japan International Cooperation Agency
KOICA	-Korean International Cooperation Agency
KFS	-Key Success Factors
MC	-Management Contract
MCDV	- Myanmar Comprehensive Development Vision
MoC	-Ministry of Construction
NCDV	- National Comprehensive Development Plan
PPP	-Public Private Partnership
PSP	- Private Sector Participation
PW	-Public Works
SLORC	-State Law and Order Restoration Council
TICA	-Thailand International Cooperation Agency
UN	- United Nations
WB	-World Bank



# MANAGING NATION BRAND THROUGH INTEGRATED MARKETING COMMUNICATION (IMC): THE CHALLENGES OF INDONESIA

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## ABSTRACT

Indonesian archipelago is strategically located between continents of Asia and Australia. It lies exactly on the equator which makes it one of the most fertile lands on earth. In terms of natural resources and diversity, the country is a fascinating place to visit. The blend of cultural and ecological array makes it a unique place to visit. Indonesia's Nation Brand or identity is based on two characteristics: culture and nature. However, that Nation Brand or identity has not been communicated effectively to the world.

Nation Brand is an exciting, complex and controversial phenomenon (Dinnie, 2008), and it is quite relevant in the context of Indonesia. It is exciting as it represents an area in which there is little existing in theory but a huge amount of real world activity; complex, because it encompasses multiple disciplines beyond the limited realm of conventional strategy; and controversial, in that it is a highly politicized activity. Indonesia, like many other countries, is in process of committing resources to the development of nation brand based on its own identity.

Indonesia has been making increasingly conscious efforts to improve its nation branding by fulfilling 3 major goals: to attract tourism, to stimulate inward investment and to boost exports. In terms of Integrated Marketing Communication, the country has been promoting *Wonderful Indonesia* logo as tourist destination. Further objectives such as talent attraction, creative industry, higher education, skilled workers, increasing international political influence are also boosted to enhance the nation brand.

However, for many decades, Indonesia has not been able to show to the world all its potentials in nature, culture, attributes and resources it has. Ironically, the image of Indonesia has been portrayed negatively, which often related to poverty, backwardness, terrorism and natural disaster. This widespread negative perception has left the *Wonderful Indonesia* logo like a hidden secret to the world.

Indonesia needs to strengthen a management of Nation Branding (Anholt, 2007) and Integrated Marketing Communication (Moriarty, 2015) plan in order to boost its *Wonderful Indonesia* and *Incredible Indonesia*. The country has not had clear integrated marketing communication strategy and there has been little involvement and coordinated works between different stakeholders. To make it worse, only few institutions have been committed in order to promote the country, while the rest of stakeholders have become burdens, rather than supporters.

This paper will analyze the current situation and tries to advocate necessary steps in order to reposition itself in the mind of potential tourists or potential business partners (customer's side) and internal environments. According to Cromwell (2006), a self-analysis is the starting point of managing nation branding. Furthermore, in order to strengthen its IMC, Indonesia needs to identify, analyze and understand the internal and external environmental forces with SWOT (Strengths – Weaknesses – Opportunities - Threats) analysis.

Keywords: nation branding, integrated marketing communication, tourism, destination management

# **MANAGING NATION BRAND THROUGH INTEGRATED MARKETING COMMUNICATION (IMC): THE CHALLENGES OF INDONESIA**

## **1. INTRODUCTION**

Indonesia strategically lies between two continents; Asia and Australia, and between two oceans; Pacific and Indian oceans. Indonesia is the largest archipelago in the world comprising 17,500 tropical islands fringed with white sandy beaches. It is estimated about 6000 of the islands are uninhabited and a number of them are even still unnamed. Straddling the equator, situated between the Pacific and the Indian Oceans, it is as wide as the United States from San Francisco to New York, equaling the distance between London and Moscow.

As a tropical country which lies on the equator, Indonesia is rich in terms of natural resources, natural beauties and cultural diversity. This made Indonesia a wonderful place to visit. The geographical fact of Indonesian archipelago has made each region in the country has its own unique characteristics and languages. Furthermore, the varied climatic zone and diversity of people offer visitors a wide range of destinations. This cultural and economical array makes Indonesia a unique place to visit.

Indonesia's national brand is based on two characteristics; nature and culture. In terms of nature, the identity that Indonesia tries to show to the world is based on its wonderful attractions, nature tourism, diving paradise, surf breaks, national parks, volcanoes, cultural events, national heritage, ancient temples, Islamic heritage, colonial heritage and gastronomy tourism. The beautiful beaches in Bali, Lombok, Raja Ampat are second to none and the natural underwater parks in Bunaken, Bali and Papua are among the best in the world. In terms of culture, Indonesia is a host of more than 300 ethnic groups with a wide variety of cultural, customs and religions background. As for the languages, Indonesia has more than the total of 500 local languages which can be found in each region in the nation. Each local language has become mother tongue for the local people whilst Bahasa Indonesia becomes national and official language. Among the main characteristic of Indonesian culture are the respect for clothing, culinary and national heritage.

The multiethnic and multicultural facts about Indonesia in a democratic system have made it a unique place, in comparison to the neighboring countries in ASEAN. However, the country faces many challenges of not being able to maximize its nation brand to the world market. Despite the fact that Indonesia has abundant potentials both in natural and cultural terms, but the image of Indonesia has been portrayed less favorable to the world in many ways. The images that often come out about Indonesia among others are terrorism, poor law enforcement, corruption, poverty, prone to natural disasters and poor infrastructure.

The negative image to some extent is degrading so that wonderful attributes of the country has remained "the secret" to the world. Promotional strategies are put in place in order to boost the nation image and brand. But the positive effects of the policies have been too little. The situation is aggravated with the decreasing reputation of the government domestically affected by the political and economical contest at home.

Indonesia's main strategy to boost the image and nation brand is through promoting tourism. In order to promote its nation brand, Indonesia regarded tourism as an important component of the economy as well as a significant source of foreign exchange revenues. The vast country of sprawling archipelago has much to offer; from natural beauty, historical heritage to cultural diversity. In 2012 the tourism sector contributes to around US\$ 9 billion of foreign exchange and surpassed US\$ 10 billion in 2013. The tourism sector ranked as the 4th largest among goods and services export sectors (Hasanuddin, 2013). In year 2014, 9.44 million international visitors entered Indonesia. Tourists from Singapore, Malaysia, China, Australia and Japan are the top five sources of visitors to Indonesia.

Despite the abundant potentials, the economic contribution from tourism industry and the volume of international tourists who entered Indonesia and from year to year is significantly below the neighboring countries in ASEAN, such as Singapore, Malaysia and Thailand. It is argued that Indonesia's performance has been crippled by unfavorable images and challenges in communication management. This paper is to identify and analyze the dynamics of Indonesia's challenges in promoting its tourism sector or destination management in the framework of nation brand and integrated marketing communication theories. This paper also aims to examine how far the stakeholders of Indonesia's nation brand implement the principles of integrated marketing communication (IMC).

## 2. BRANDING INDONESIA AS A DESTINATION

It is known that places compete in attracting visitors, residents and businesses. In addition, place reputation or brand plays a hugely significant role in determining just how successful they are in this competition. Within the framework of place branding are holistic approaches of nation branding and country branding that aim to create competitive vision for the future of the nation and country, both of which are rather difficult and complex due to the abstract and uncontrollable nature of the subject matter (Anholt, 2005). Increased economic competition among countries resulted in their need to brand themselves, especially in the domains of exports, direct foreign investment and tourism (Kotler and Gertner, 2002). Places which have strong and dynamic brands have easier time attracting businesses and talent within the knowledge economy. The very term "*destination, competitiveness, authenticity, creativity, and place brand*" are often slippery, elusive, contested and often misunderstood.

A consumer brand with genuine equity builds emotional connections and brings powerful identity benefit, drives consumers' behavior and shapes their perceptions of reality; it opens doors, creates trust and respect and raises expectations of quality and integrity. In short a strong brand has a positive "reputation". So in managing a place brand, it means "powerful mediator" of culture, communities, and peoples and if it has a positive reputation it will find it easier to compete for attention, resources, people, jobs and money. A positive place reputation builds place competitiveness and creates a reservoir of goodwill. Image building marketing activities have been done since 1980s by cities and even countries.

Countries, regions and cities embraced the strategies, responding to a need to compete more effectively, to create a strategic decision-making framework and, in some cases, to increase accountability to their stakeholders. Many destinations now see place branding (which is broader than simply tourism and may encompass all or some of the following:

inward investment, exports, culture, sports, events, education and immigration) as a major part of their competitive armory.

In the case of Indonesia, the official government institution that is responsible for tourism sector is the Ministry of Tourism. A series of campaigns to promote Indonesian tourism have been launched, either by government or private sectors through various medias; printed media, television and internet. "Wonderful Indonesia" has been the nation's brand since 2011 replacing the previous one "Visit Indonesia" brand which was initially launched in 1990s. The selection of the new brand and logo improved Indonesia's performance. The minister of tourism announced that in 2010, foreign tourists visiting Indonesia touched 7 million and reached 7.7 million in 2011. Wonderful Indonesia as a new branding was believed describing the country's beautiful nature, unique culture, varied food, hospitable people and price competitiveness in Indonesia. The positive trend continues to grow until 2015.

The concerted national policy to brand Indonesia as a tourist destination only started from 1991. Learning from the success of the neighbor countries, such as Thailand, Singapore and Malaysia who had successfully gained great benefit from their tourism sector through intensive promotions, then Indonesian government launched a policy to strengthen its nation brand. It is a chance to open the secret of wonderful Indonesia to the world. The "wonderful Indonesia" concept highlights Indonesia's wonderful nature, cultures, people, food, and value for the money. Both nature and culture are major the components of Indonesian tourism. According to the data from Tourism in Indonesia published by the relevant ministry, there are some facts about the components of wonderful Indonesia.

### **Nature tourism**

In terms of nature tourism, Indonesia has a well-preserved, natural ecosystem with rainforests that stretch over about 57% of Indonesia's land. Forests are examples of popular tourist destinations. Moreover, Indonesia has one of longest coastlines in the world, measuring 54,716 km (33,999 miles), with numerous beaches and island resorts, such as those in Bali, Lombok, Bintan and Nias Island. However, most of the well-preserved beaches are those in more isolated and less developed areas.

With more than 17,508 islands, Indonesia is rich in diving sites and surf breaks. With 20% of the world's coral reefs, over 3,000 different species of fish and 600 coral species, deep water trenches, volcanic sea mounts and an endless variety of underwater life have become excellent scuba diving activities in Indonesia. Bunaken National Marine Park, at the northern tip of Sulawesi, claims to have seven times more coral than Hawaii. According to Conservation International, marine surveys suggest that the marine life diversity in the Raja Ampat, Indonesia province is the highest recorded on Earth.

Surfing sites in Indonesia are recognized as world class according Pacific Islands Surf Sports and Surfing Information. The well-known sports are mostly located on the southern, Indian Ocean side of Indonesia, for example, the large oceanic surf breaks on southern Java. Two well-known surf breaks in Indonesia are the G-land in the Bay of Grajagan, East Java and Lagundri Bay at the southern end of Nias island. Since the Hawaiian scale waves were discovered at Lagundri Bay, the island has become famous for surfing worldwide.

There are 50 national parks in Indonesia, of which six are World Heritage listed. The largest national parks in Sumatera are the 9,500-square-kilometre (3,700 sq mi) Gunung Leuser National Park, the 13,750-square-kilometre (5,310 sq mi) Kerinci Seblat National Park, and the 3,568-square-kilometre (1,378 sq mi) Bukit Barisan Selatan National Park. All the three tropical rainforests heritage of Sumatera is recognized by UNESCO World Heritage. Other national parks on the list are Lorentz National Park in Papua, Komodo National Park in the Lesser Sunda Islands, and Ujung Kulon National Park in West Java. Different national parks offer different biodiversity, as the natural habitat in Indonesia is divided into two areas by the Wallace line. The Wallace biogeographical distinction means the western part of Indonesia (Sumatra, Java, Kalimantan) have the same flora and fauna characteristics as the Asian continent, whilst the remaining eastern part of Indonesia has similarity with the Australian continent.

Though volcanic mountains can be dangerous, they have become major tourist destinations. Mount Rinjani among Indonesia's second highest volcano and a popular destination for climbers visiting Lombok in eastern Indonesia. Popular active volcanoes are the 2,329-metre (7,641 ft) high Mount Bromo in the East Java province with its scenic volcanic desert around the crater, the upturned boat shaped Tangkuban Perahu and the volcanic crater Kawah Putih, north and south of Bandung respectively and both with drive-in access up to the crater, the most active volcano in Java, Mount Merapi near Yogyakarta, and the legendary Krakatau with its new caldera known as anak Krakatau (the child of Krakatau). Gede Pangrango volcano in West Java is also a popular hiking destination, especially among domestic hikers.

### **Culture tourism**

Despite foreign influences, a diverse array of indigenous traditional cultures is still evident in Indonesia. Cultural tourism plays a significant part in promoting nation brand, such as in Yogyakarta and Toraja for instance. The rise and fall of Buddhist, Hindu, and Islamic kingdoms in Central Java has transformed Yogyakarta into a melting pot of Indonesian culture. Most major Indonesian cities have their state-owned museums, although most are in modest display. The most complete and comprehensive museum that displaying Indonesian culture and history spanned from prehistoric to colonial era is National Museum of Indonesia located in Thailand. For visitors unable to visit all Indonesian provinces, Taman Mini Indonesia Indah provides a comprehensive microcosm of Indonesian cultures.

Along the Indonesian classical history of Hindu-Buddhist era, ancient generations produced some temples and monuments called candi or temple. The best-preserved Buddhist shrine, which was built during the Sailendra dynasty in the 8th century, is Borobudur temple in Central Java. A giant stone mandala stepped pyramid adorned with bell-shaped stupa, richly adorned with bas-reliefs telling the stories and teachings of Buddha. The Hindu temple Prambanan and The Buddhist temple Borobudur are listed in the UNESCO World Heritage list since 1991. Smaller temples are scattered all around Indonesia.

Islam has also contributed greatly to the cultural society in Indonesia. Islamic culture is prominent in Sumatera and a few of the remaining sultanate palaces can be seen in Medan and Tanjung Pinang. The Islamic heritage tourism is also popular, especially among Indonesian Muslims and Muslims from neighboring countries such as Malaysia, Singapore and Brunei that shared common Southeast Asian Islamic heritage.

Most of Indonesian major cities have their own historical or monumental Grand Mosque that became city's landmark as well as tourism attraction. Istiqlal Mosque, Jakarta, the Indonesian national mosque and the largest in Southeast Asia is Jakarta's major landmark as well as tourist attraction.

The heritage tourism is focused on specific interest on Indonesian history, such as colonial architectural heritage of Dutch East Indies era in Indonesia. The colonial heritage tourism mostly attracted visitors from the Netherlands that share historical ties with Indonesia, as well as Indonesian or foreign colonial history enthusiast. Among the favorite places to visit are museums, churches, forts and historical colonial buildings, as well as some colonial heritage hotels.

Urban tourism activities includes shopping and sightseeing in big cities, or enjoying modern amusement parks, resorts, spas, nightlife and entertainment. To some extent urban tourism might also involve municipal culture and heritage tourism, such as visits to city museums or parts of colonial old town.

As a melting pot of many cultures, Indonesia has rich and diverse culinary traditions, and might be considered as one of the richest and the best in the world; such as *rendang* that recently voted as the number one dish of CNN International 'World's 50 Most Delicious Foods' list. Many regional cuisines exist, often based upon indigenous culture and foreign influences. Indonesian cuisine varies greatly by region and has many other different influences.

Despite the above potentials, Indonesia's performance in attracting foreign tourists is relatively low compared to other ASEAN Countries, such as Malaysia, Thailand and Singapore. In 2014, while Indonesia welcomed 9.4 millions foreign tourists, Thailand and Malaysia had enjoyed welcoming 24.78 million and 27.44 million respectively.

#### **Tourism Data of Thailand, Indonesia, Malaysia and Singapore**

	<b>THAILAND</b>	<b>INDONESIA</b>	<b>MALAYSIA</b>	<b>SINGAPURA</b>
<b>Free tourist visa</b>	57 countries	75 countries (since Sept 2015)	161 countries	80% countries globally
<b>Volume of foreign tourists (in millions)</b>	2011: 19.23 2012: 22.35 2013: 26.55 2014: 24.78	2011: 6.75 2012: 8.04 2013: 8.8 2014: 9.44	24.71 25.03 25.72 27.44	2011: 13,2 2012: 14,5 2013: 15,6 2014: 15,1
<b>Contribution of Tourism Sector to GDP</b>	8,6 % in 2014	3.2 % in 2014	5.7 % in 2014	5.8 % in 2014

Source: World Travel & Tourism Council

### 3. NATION BRAND AND IMC

In investigating the efforts to promote the destination of Indonesia and its rich potentials, it is not surprising to learn the fact that Indonesia's nation brand is still weak, and therefore needs improvement. This paper will utilize the theories of Nation Branding or Competitive Identity as a tool analysis to investigate the challenges of Indonesia.

Nations do not belong to brand managers or corporations; indeed, it belongs to the whole nation's entity. Nations are increasingly developing strategies to promote their country branding with aims to attain main objectives: to attract international tourists, to stimulate trade and investment (TTI). The objectives of each country vary according to the condition of the respective countries. Some countries further targets, such as attracting more international students, international patients, sports lovers or entertainments lovers and etc.

Temporal proposed a wider set of potential rewards from nation branding, who suggests that in addition to the key goals of attracting tourists, stimulating inward investment and boosting exports, nation branding can also increase currency stability, help restore international credibility and investor confidence, reverse international ratings downgrades, increase international political influence, stimulate stronger international partnerships and enhance nation building by nourishing confidence, pride, harmony, ambition, national resolve. (Temporal, 2006)

In order to achieve the above objectives, it is imperative to adopt conscious branding if they are to compete effectively on the global (Kotler and Gertner, 2002). A powerful and positive nation-brand can provide crucial competitive advantage in today's globalized economy.

It has also been argued that thoughtful brand positioning gives a country a competitive advantage over other nations (Anholt, 1998) and that active repositioning of a country through branding can be done successfully and holds great potential for countries, particularly in cases where a country's stereotype lags behind reality.

A further incentive for countries to embrace branding lies in the capacity of branding techniques to create meaningful differentiation. In tourism sector, for instance, most destinations make almost identical claims regarding the beauty of their scenery, the natural beauty of their beaches, the hospitality and so on, and therefore, the need for destinations to create a unique identity, to find a niche and differentiate themselves from their competitors, is more critical than ever (Morgan, 2002). The above strategy should be done on a long-term strategic basis, not a sporadic one.

Nation branding, however, extends beyond the familiar realm of tourism marketing and encompasses a range of further objectives.

Vanossi states that it has never been clearer than in today's globalized world, countries and regions and cities suddenly have to compete with each other for tourism, investment, aid, membership of supernatural groups, for buyers of their products and services, and for talented people (Vanossi, 2006). Most places are according to Vanossi, in need of clear and realistic strategies for communicating and promoting them, which leads to the question of which consultants or agencies will ultimately lead the field in managing and promoting these complex and often contradictory megabrands.



Vanossi rhetorically asks whether promoting a country is more about policy, management consultancy, public relations, customer relations management, advertising or brand strategy, or whether it is a combination of everything. Simon Anholt elaborated that Nation Brand or Competitive Identity can be analyzed with the Anholt-GfK Nation Brands Index SM (NBI). (Anholt, 2015)

It helps governments, organizations and business understand, measure and ultimately build a strong national image and reputation. It measures the power and quality of each country's brand image by combining the following six dimensions:

1. Exports – the public's image of products and service from each country and the extent to which customer proactively seek or avoid product from each country of origin.
2. Governance – public opinion about national government competence and fairness as well as if perceived commitment to global issues such as peace and security, justice, poverty and environment.
3. Culture and heritage – global perception of each nation heritage and appreciation for contemporary culture, including film, music, arts, sports and literature.
4. People – the population reputation for competence, openness, friendliness and other qualities such as tolerance.
5. Tourism – the level of interest in visiting a country and the draw of natural and man-made tourist attraction.
6. Investment and immigration – the power to attract people to live, work or study in each country and how people perceive a country quality of life and business environment.



**The Nation Brand Hexagon @ 2000 Simon Anholt**

In the case of Indonesia, it appears that Indonesia has paid great attention in building its nation brand in tourism but unexpectedly paid less attention to the other 5 factors as stated by Anholt. So the term nation brand is often mistakenly perceived as tourist destination brand. The government of Indonesia has every institutions or ministries handling the 6 factors of nation brand.

But ironically, Indonesia at the same time suffers from the bad image as well. The bad image is partly disseminated by media, including social media. The image of Indonesia that has been more communicated to the international community is associated to natural disasters, terrorism, corruption, issues security and safety. This phenomenon proves that

communication management in the body of Indonesian government and all stakeholders is not yet efficient to some extent.

If Indonesia wants to learn from the other ASEAN countries, then Indonesia must now portray itself based on its values and attractiveness. In turn, Indonesia must possess ability to communicate correctly its potentials to the world.

Indonesia has everything what the tourism industry needs; from marine sports, diving, eco-tourism, adventure tourism and urban tourism, but interestingly, Indonesia as a destination of international tourists is still far below Thailand, Malaysia and Singapore.

It is relevant for Indonesia to analyze its current situation and take necessary steps in order to reposition itself in the mind of potential tourists. According to Cromwell (2006), a self analysis is the starting point of a nation-branding process. Indonesia needs to identify, analyze and understand the internal and external environmental forces which influenced the result.

In SWOT (Strength – Weakness – Opportunity – Threat) Analysis, challenges in building Indonesia’s nation brand can be summed up as follows:

<p><b>STRENGTH</b></p> <ul style="list-style-type: none"> <li>- The beauty of nature</li> <li>- Rich culture and heritage</li> <li>- The increasing state-budget for promotion</li> <li>- Security and political stability</li> </ul>	<p><b>WEAKNESS</b></p> <ul style="list-style-type: none"> <li>- Focusing on tourism sector and pay inadequate attention to other sectors in nation brand</li> <li>- Inefficient marketing communication management among stakeholders</li> <li>- Weak connectivity in terms of infrastructure</li> <li>- Inefficient bureaucratic system</li> <li>- Psychological inferiority complex</li> <li>- Misperception about tourism industry</li> <li>- Weak brand</li> </ul>
<p><b>OPPORTUNITY</b></p> <ul style="list-style-type: none"> <li>- Hospitability as part of culture</li> <li>- Democratic society</li> <li>- Cheap labor cost</li> <li>- Campaign on improving good governance</li> <li>- Creative and Innovative human resources</li> </ul>	<p><b>THREATS</b></p> <ul style="list-style-type: none"> <li>- External economic and financial crisis</li> <li>- Internal political and security issues</li> </ul>

Challenges faced by Indonesia in promoting its nation brand are broad. But the most conspicuous ones are among others: the slow development of infrastructure to support tourism across the sprawling archipelago, incursions of the industry into local traditions (adat), and the impact of tourism development on the life of local people. The tourism industry in Indonesia has also faced setbacks due to problems related to security. In 2002,

travel warnings have been issued by some countries over terrorist threats and ethnic as well as religious conflicts in some areas, significantly reducing the number of foreign visitors for a few years. However, the number of international tourists has bounced back positively since 2007 up to 2014.

In 2015, based on World Economic Forum survey, Indonesia got Travel and Tourism Competitiveness Index score 4.04 and rank at number 50, (up from number 70 in 2013, number 74 in 2011 and number 81 in 2009) from 141 countries. Malaysia and Thailand are ranked 25 and 35 respectively. According to the survey, aspects that need to be improved to move up the rank ladder are; tourism and ICT infrastructures, health and hygiene, environmental sustainability, and affinity for travel and tourism.

However, above all there is not yet a concerted national strategy to address the above mentioned challenges. Efforts and policies exist but they come up more sporadically, without sustainability. Those challenges can be addressed in a better way by implementing the concept of Integrated Marketing Communication (IMC) with total communication strategy. (Moriarty, 2015)

IMC is an important business concept as well as a set of principles and practices. In the analysis of IMC, it is important to underline the focus of the study is involving the entire stakeholders, which includes customers. Interactive and respectful communication is the link that connects brands and their key stakeholders and the glue that joins them in respectful long-term relationships. The possibility of authentic two-way communication has exploded with the development of digital technology and social media. All stakeholders are critical in relationship marketing because there are communicators who can send either positive or negative messages about the brand. It is essential to keep in contact with those stakeholders, but it is even more important to set up relationship programs that invite two-way communication and let them initiate messages.

In total communication strategy, all stakeholders from traditional as well as nontraditional media should be involved. It is essential to remember that in 360 degrees communication planning, there are other message delivery points in the way a company does business. A total communication program monitors all these sources of brand messages. Contemporary brand communication includes two-way as well as targeted strategies – receiving and responding to messages is as important as sending them.

In the course of building marketing communication in Indonesia's context, the concept of contact points should be redefined and broadened the understanding of media as a message delivery system. Contact points are the various ways a customer comes in contact with a brand. This view of media moves from traditional advertising media (print, broadcast and outdoor) and media of various marketing communication functions (press release, events, promotional materials and sponsorships) to experiential contacts that in previous advertising-dominated media plans weren't generally considered to be media, such as word of mouth and customer service. This contact point management is the way marketing communication planners develop systems of message delivery – both to and from all key stakeholders. The objective is to maximize and leverage the good contact points and minimize the bad ones.

The brand touch points are essential because the impact of these personal experiences can influence the stakeholders' feelings about a brand. Consumers may receive information and impressions about the nation brand of Indonesia at a contact point, but a touch point is a

brand experience that delivers a message that also touches emotions leading to positive and negative judgments. It has more emotional impact than a regular contact point. A critical touch point is one that connects the brand and customer on an emotional level and leads to a yes-or-no decision about a purchase decision or a brand relationship. One reason for this challenge is that Indonesia must enhance clear and sustained marketing strategies by embracing all stakeholders.

#### **4. CONCLUSION**

Indonesia's strategy to improve its nation brand has been focused on destination management, particularly tourism sector by promoting Wonderful Indonesia. Despite Indonesia has abundant potentials, developing tourism is not an easy task for Indonesia because of fact of challenges. The management of nation branding has limitation where Indonesia has paid great attention in building the nation brand in tourism but unexpectedly paid less attention to the other 5 factors as stated. So the term nation brand is often mistakenly perceived as tourist destination brand.

Indonesia regarded the tourism sector as a stepping stone to boost the nation brand the bigger frame. Tourism industry is a strategic sector for Indonesia's economy because of two reasons: Firstly, it absorbs labors quickly thus has very positive economic impact for the nation. Secondly, it can boost Indonesia's good image effectively in relatively a short time of period. The success in tourism sector will lead to further successes in other pillars of nation brand.

Therefore, managing nation brand through integrated marketing communication is not a simple thing in Indonesia. IMC in practice must involve all stakeholders among others by improving coordination, improving human resources, improving, strengthening concerted promotion and improving the quality of good governance. Improving the integrated marketing communication will boost the nation brand of Indonesia.

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# **PROBLEMS AND CHALLENGES FACED BY WOMEN ENTREPRENEUR IN INDIA: A CASE STUDY WITH SPECIAL REFERNCE TO RAJASTHAN**

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## **ABSTRACT**

Technological innovation and modern way of thinking reduces the disparity between man and women, and bring about equality and equity between them, the need of the hour in women empowerment both through provision of employment and enterprise creation. Women entrepreneurs have been making a significant impact in all segments of the economy in Canada, Great Britain, Germany Australia, US and so in India. The Government of India has defined women entrepreneurs based on women participation in equity and employment of a business enterprise. Accordingly, a woman entrepreneur is defined as an enterprise owned and controlled by a woman having a minimum financial interest of 51% of the capital and giving at least 51% of the employment generated in the enterprise to a woman. It is the group of women or single women running an enterprise or company in order to earn profit. Now days because of women empowerment women are stepping-stone into the industries and are taking the place of men. Now a day's women's are running several businesses like beauty parlors, switching shops, boutiques, etc. Other areas chosen by women are retail trade, restaurants, hotels, education and cultural.

The main aim of the research paper is to find out what problems hinder women – in these case women entrepreneurs – in creation and maintenance of their own enterprise. In this paper, primary research has been made through questionnaire where women entrepreneurs were questioned about the problems they faced when starting up an enterprise and problems they face in the day-to-day running of their businesses. More general questions about the size of their enterprises, their family background and their qualifications were raised in order to complete the picture. The managerial implications and policy making implications are also discussed.

Keywords: Women entrepreneur, Enterprise, Opportunities, Challenges

# **PROBLEMS AND CHALLENGES FACED BY WOMEN ENTREPRENEUR IN INDIA: A CASE STUDY WITH SPECIAL REFERNCE TO RAJASTHAN**

## **1. INTRODUCTION**

A study conducted by Srinivasan N.P. (2001) state that women perform 66 percent of the world's work, produce 50 percent of the food, but earn 10 percent of the income and own 1 percent of the property. Globally, women represent 49.6% of the total population, but only 40.8% of the total workforce in the formal sector. Since ages India has been men-dominated country. But, time is changing now. Women in India have outraged the fact that since hundreds of years they had been following the orders of men. They now know their rights and duties and with the spreading awareness amongst the women they are now no less than the men. They are walking with men at the same pace in each and every field. In former days, for Women there were 3 Ks- Kitchen, Kids, Knitting, then came 3 Ps- Powder, Papad, Pickles and now at present there are 4 Es- Electricity, Electronics, Energy, Engineering.

Indian women had undergone a long way and are becoming increasingly visible and successful in all spheres and have shifted from kitchen to higher level of professional activities. Women entrepreneurs are fast becoming a force to reckon with in the business world and are not only involved in business for survival but to satisfy their inner urge of creativity and to prove their capabilities. Educated Women is contributing to a great extent to the social transformation and in the future, will be seen that more women venturing into areas traditionally dominated by men. Today, many women have established their own economy i.e., entrepreneurial empire and are now ruling their world as they wished to. The hidden entrepreneurial potentials of women have gradually been changing with the growing sensitivity to the role and economic status in the society. Skill, knowledge and adaptability in business are the main reasons for women to emerge into business ventures.

## **2. METHODOLOGY**

The study was conducted in Rajasthan State of INDIA. Random sampling technique was adopted for the selection of study area. A sample of 100 women respondents was taken on the basis of criterion that they should be running their enterprise independently and not in partnership. Enterprises taken up for the study were boutiques, beauty parlors, primary schools and general stores to analyze the process and styles of management. For in-depth analysis, 50 women entrepreneurs from this 100 sample were taken. The sample was selected using non-random opportunity sampling technique as the list of women entrepreneurs available with the business development organizations did not tally to a great extent with the existing women entrepreneurs. In this research, interview and case study techniques were employed and the data was collected using the following tools:

- Interview schedule: to collect socio, economic, demographic profiles for in-depth analysis of women entrepreneurs.
- Entrepreneurial personality questionnaire (Dina Lavoie, 1994): to evaluate the entrepreneur and non-entrepreneur personality of the women entrepreneurs.

- Entrepreneurial management questionnaire (Dina Lavoie, 1994): to evaluate the management styles of women entrepreneurs.

### 3. RESULTS AND DISCUSSION

Socio-economic and demography profile of women entrepreneurs was prepared to project their characteristics. Most of the women entrepreneurs (54%) belonged to the age group of 36 and above followed by the age groups of 26-35 (28%) and 16-25 (18%) in that order. It appears women think of business idea in their thirties due to economic pressure/demand and more leisure time as their children are growing.

Half (51%) of the women interviewed, belonged to the low income level. 38% of them belonged to the middle class and 11 per cent belonged to the high income strata respectively. The data indicate that economic need is the essential triggering factor for the women to enter into entrepreneurship. On the other hand women with small families enter into entrepreneurship compared to those with large families who are generally depending on wage employment. Immediate gratification is the driving force for the women with large families to decide on the strategy for economic development.

50% of women entrepreneurs had education less than S.S.C., 18% were illiterates, 13% had education up to SSC and the remaining 19% had college education. The data indicates that majority of the women entering into business have quite low education.

Majority (76%) of the women entrepreneurs were married and only low per cent of them were unmarried (8%), widows (10%) and divorces/separated (6%). Married women experience freedom and receiving support directly and/ or indirectly to start and manage their enterprises. Further parents were expressing that economic independence through entrepreneurship is a barrier in fixing their marriage alliances.

Majority (60%) of the respondents had fewer than two children, which included 18% who had no children, 12% were single parent, and 37% of the women entrepreneurs had two children. Only 40% of women entrepreneurs had more than two children. It is clear from the data that more women with small families enter entrepreneurship compared to those with large families. This is in good comparison with results obtained by Verma (2006). Data expressed that fewer number of children means less responsibility and more free time which must be a facilitating factor for women to take up entrepreneurship.

Entrepreneurial personality of the women entrepreneurs was assessed using simple questionnaire. The questions on entrepreneurial personality characteristics include initiation, risk taking, sociability, leadership independence etc. The data collected reveals that entrepreneurial personality traits range from low average to high average and thus concluding that women entrepreneurs possessed only average personality profile. Several factors like socio, economic demographic and cultural might be responsible for the existing average entrepreneurial personality profile. Management styles of women entrepreneurs were also analyzed using another questionnaire contained questions on four entrepreneurial management skills i.e., producer, administrator, integrator and entrepreneur. It was observed that they have average production skills and average entrepreneurial skills. This entrepreneurial skills include preoccupied by external system, by change, by creativity and by



new demands. Administration skills are found to be low. Integration skills are found to be very good, that is personnel skills, communication skills, negotiation skills, co-ordination skills etc. Integration skills are identified as one's concern to establish, maintain and sustain effective relationships with others. This is found to be important for those whose aim in life requires sacrifices and an avoidance of inter-personal conflicts in order to succeed.

52% of women entrepreneurs invested only below Rs.1000/- for their enterprises while 30% invested Rs.1000/- to Rs.5000/- and only 18% invested more than Rs.5000/-. This supports the fact that limited access to finance is the factor that works against the economic progress of women. Legally the property that is to be converted for the business is not often either inherited or belonged to the wife. So the freedom that is enjoyed in converting such assets into cash is naturally very limited. One factor found among women was that they would not go for large investment.

Most of the women entrepreneurs are aware of the support systems from banks, but many more are not aware of the support systems helping women entrepreneurs. This need emphasizes for orienting them with various incentives and assistance provided by the government and financial institutions and ways of accessing them. Few percentage of women entrepreneurs are utilizing the services of support systems such as banks, governmental schemes and women groups and a large percentage of women entrepreneurs are constrained to use them. The procedures of bank loans, the delay and the running about involved discourages many a women from borrowing from banks. As the assistance from some government services and women groups is meager, they are borrowing from the relatives and money lenders at high rate of interest. 68% of women entrepreneurs took only below 1 month time for planning the business and 32% of women entrepreneurs took more than one month time for planning the business. Skill in planning is influenced by factors like entrepreneurial personality traits, formal managerial training etc., In the absence of formal training, the quality of planning are generally affected and an adverse kind of results are seen in their businesses. Number of hours devoted for business is one of the important factors in business, 14% of women entrepreneurs are devoting only 1-3 hours per day for business whereas 56% are devoting 4-6 hours and 30% of women entrepreneurs devote more than 6 hours per day respectively. When taken the number of hours devoted for family by these entrepreneurs, 36% of women entrepreneurs are devoting 1-3 hours per day for household work in the family and this group is mostly the married women who have grown up children, and getting help from the children in household chores. It is evident that women are devoting more or less as much as time for both family and business. Women differ from men with respect to the conflicting demands of business and family. Married women entrepreneurs typically find that their husbands expect them to continue with their household duties despite the demands of their businesses and they rarely assist in running of houses.

#### **4. SUGGESTIONS**

- There should be a continuous attempt to inspire, encourage, motivate and co-operate women entrepreneurs.
- Attempts should be there to enhance the standards of education of women in general as well making effective provisions for their training, practical experience and personality development programs, to improvise their over-all personality standards.

- Attempts to establish for them proper training institutes for enhancing their level of work-knowledge, skills, risk-taking abilities, enhancing their capabilities.
- Attempts to bring about a society attitude change, generation of awareness and consciousness on the policy of self-development of women entrepreneurs.
- Attempts by various NGO's and government organizations to spread information about policies, plans and strategies on the development of women in the field of industry, trade and commerce.
- Establishing various policies to offer easy finance schemes for economically strengthening the position of women.
- Forming a cooperative association of women entrepreneurs to mobilize resources and pooling capital funds, in order to help the women in the field of industry, trade and commerce.
- Offering seed capital, up-liftment schemes, women entrepreneurs fund etc. to encourage them economically.
- To extend concessional rates facilities and schemes for women entrepreneurs to prosper in the field of enterprise.
- To establish all India forums to discuss the problems, grievances, issues, and filing complaints against constraints or shortcomings towards the economic progress path of women entrepreneurs and giving suitable decisions in the favor of women entrepreneurs and taking strict stand against the policies or strategies that obstruct the path of economic development of such group of women entrepreneurs.

## **5. CONCLUSION**

It can be concluded that women entrepreneurs faced multiple problems among the problems economic problem is main. Higher prospects are indicated by women entrepreneurs and within the service sector corporate/industries have the shows higher prospects to women. It can be said that today we are in a better position wherein women participation in the field of entrepreneurship is increasing at considerable rate, efforts are being taken at the economy as well as global level to enhance woman's involvement in the enterprise sector. This is mainly because of attitude change, diverted conservative mindset of society to modern one, daring and risk-taking abilities of women, support and cooperation by society members, changes and relaxations in government policies, granting various up-liftment schemes to women entrepreneurs etc.

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# **AN ANALYSIS ON COUNTRY-SPECIFIC CHARACTERISTICS INFLUENCING SMARTPHONE USAGE**

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## **ABSTRACT**

Today smartphones and modern mobile networks are globally standardized, from a technical perspective, and sold across international markets with only minor modifications. However, smartphone penetration and usage differs between countries. It can be assumed that this is because of country-specific differences with regards to factors such as economic wealth or network infrastructure. When analyzing smartphone usage in more detail, e.g. its usage for mobile social media, gaming, or video, cultural characteristics might also have an influence on the usage behavior. Against this background, the objective of this study is to analyze country-specific characteristics influencing smart phone usage. Country-specific data at this level is very rare so the study relies on a one year snapshot from 2013. Cultural characteristics are included in the study based on Hofstede's cultural dimensions. The consolidated dataset was evaluated using correlation analysis to identify statistical relationships between indicators describing smartphone usage and country characteristics. This study might give some initial indications on further research in this field and how to more efficiently adapt smartphone-based product portfolios and strategies to country-specific requirements.

**Keywords:** Cross-country Analysis, Smartphone Usage, Mobile Media Usage, Mobile Services, Cultural Characteristics

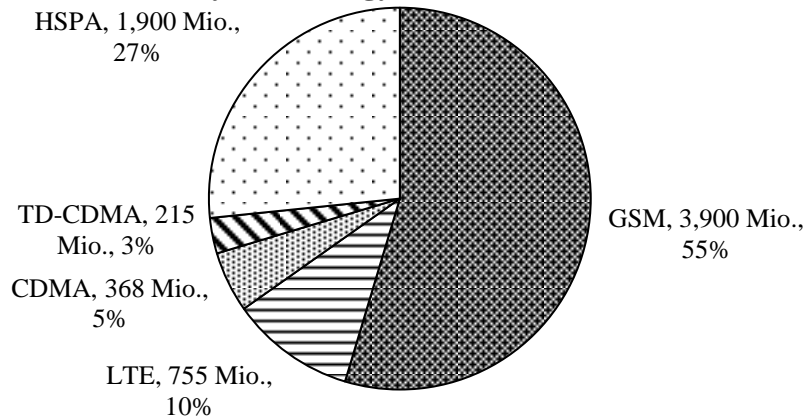
# AN ANALYSIS ON COUNTRY-SPECIFIC CHARACTERISTICS INFLUENCING SMARTPHONE USAGE

## 1. INTRODUCTION

According to the GSM Association, there were 7.1 billion global SIM connections and 3.6 billion unique mobile subscribers at the end of 2014. With nearly 13 million people directly employed, the mobile industry generated 3.8 percent of the global gross domestic product (GDP) with a total value of about US\$ 3 trillion. Besides the direct and indirect contribution of mobile operators, related industries and the general economy, a larger proportion (US\$ 1.7 trillion) of this value can be attributed to the productivity improvements resulting from mobile technologies deployment (GSMA, 2015a). The ecosystem of mobile services is a relatively new economic sector. Cellular mobile communication was introduced in the mass markets about three decades ago. The underlying technology of the so called first generation networks consisted of a variety of different network standards and focused mainly on voice communication. Some of the first generation standards obtained only national importance such as the Radiocom 2000 in France or the Radio Telephone Mobile System (RTMS) in Italy. Other standards were employed on a more international scale. AMPS (Advanced Mobile Phone System), NMT (Nordic Mobile Telephony), and the TACS (Total Access Communications System) were amongst the most popular first generation standards. This resulted in the global mobile communications market being largely fragmented. Handset manufacturers and network equipment providers developed and produced their products mainly for national markets or at a very limited international scale. Mobile subscribers could not use their phones globally and thus often had to switch phones and subscriptions when passing national borders. This changed with the introduction of the second generation mobile network standards in the early 1990s. Although some countries and regions established their own standards, e.g. cdmaOne in the Americas and parts of Asia, the European GSM (Global System for Mobile Communications) technology became the dominant international mobile communications standard. The GSM standard introduced a digital cellular technology offering voice, data, and messaging services.

Today, GSM networks cover more than 90 percent of the world's population and enable mobile communication in up to 219 countries (GSMA, 2015b). International roaming support and globally harmonized radio spectrum enabled GSM subscribers to use their handsets globally. Moreover, the GSM technology laid the foundation of a migration path towards mobile broadband communications in 3G and 4G networks. The third generation mobile system, based on GSM, is the popular UMTS (Universal Mobile Telecommunications System) standard. When introduced, this technology enabled transfer rates up to 384 kbit/s for data communication. Today, improved by HSPA (High Speed Packet Access), UMTS subscribers can expect data rates ranging from several Mbit/s to more than 40 Mbit/s depending on the network infrastructure and the local conditions. The next step in the evolution of mobile networks is LTE (Long Term Evolution) with a data speed of up to several 100 Mbit/s. In the year 2014 LTE was already available in over 335 networks in 118 countries (GSMA, 2015a). Figure 1 shows the percent of global mobile subscribers by technology in June 2015. While TD-CDMA is a variant of the UMTS air interface, the CDMA section in this chart contains other mobile network technology standards outside the GSM migration path.

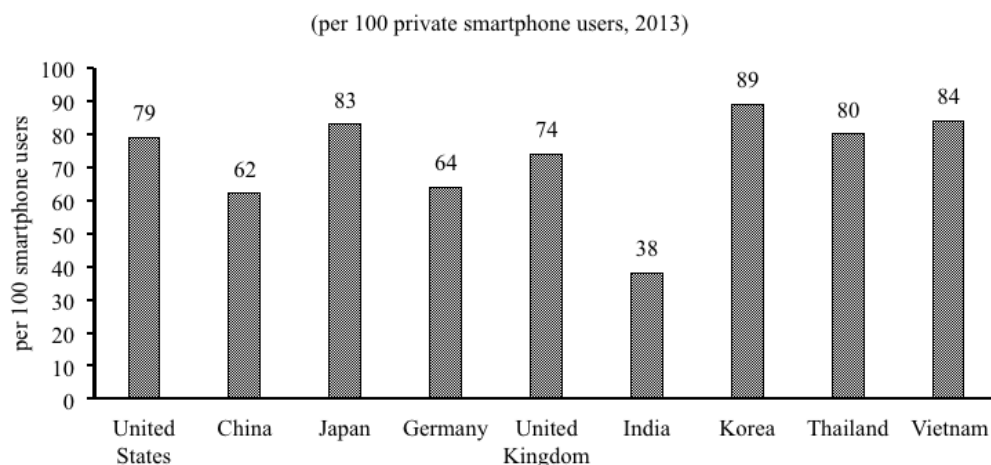
**Figure 1: Global Subscribers by Technology (June 2015)**



Source: 4GAmericas (2015)

Availability of LTE networks varies significantly across countries. While 4G coverage reached 90 percent of the population in developed countries, it only reached 15 percent for the developing world. In this context it also needs to be considered that although the proportion of global 3G and 4G broadband connections has evolved significantly within the last years, 2G still accounts for 60 percent of the global mobile connections (GSMA, 2015a). The aforementioned technical improvements and higher data speeds of modern mobile communication networks fueled mobile usage of the Internet and enabled a new mobile ecosystem based on advanced services and applications. Examples of these services in the consumer segments are mobile social networking, mobile gaming, mobile audio and video streaming as well as mobile banking and commerce applications. International studies that have systematically analyzed the usage behavior related to these innovative mobile services are very rare. Google published country reports on smartphone usage behavior including these innovative services more recently in 2013 (Google, 2013). Based on this report, Figure 2 shows, for some selected countries, the proportions of smartphone users that use their devices to access the mobile web on a daily basis. It is obvious that there are significant differences in smartphone usage behavior across countries. When considering all publicly available country reports that were of relevance to this study, mobile web usage varied from 38 to 89 per cent with a mean of 70.3 percent (standard deviation of 10.4).

**Figure 2: Daily Mobile Web Usage by Smartphone Users in Selected Countries 2013**



Base: Private smartphone users

Source: Google (2013)

Considering a common technical platform of smartphone usage based on global 2G, 3G and 4G standards, observed differences in the global usage of mobile services cannot be explained by different technologies. Thus the differences must be related to the country specific migration paths or environmental factors which affect the telecommunications standards and service offerings. The PEST analysis provides a popular framework for analyzing a business environment from a market research or strategic analysis perspective (Frynas & Mellahi, 2014; Peng & Nunes, 2007). PEST stands for the Political, Economic, Social, Technological macro-environment. In the context of a cross-country analysis of mobile service usage, this approach can be used to identify some initial factors that might characterize the different national mobile service markets:

- *Political factors* describe the legislation and governmental regulations as well as interventions in the market. In general, mobile telecommunication markets are regulated and mobile network operators require licenses from regulatory authorities to get access to radio spectrum and offer services to the public. These licenses may contain legal regulations on network coverage, services to offer, as well as the technological standards to be deployed. Due to this fact the regulatory policy can have a direct influence on the timing of the market introduction of new standards and the service quality of mobile service offerings.

- *Economic factors* such as Gross Domestic Product (GDP), interest rates, or disposable income describe the situation and wealth of a whole economy in which a business is operating. Implementation of nationwide network infrastructures requires massive capital investments. Mobile handsets and the network infrastructure are produced by global players and then deployed in national markets. Thus it can be expected, that the economic wealth of a nation will have an impact on the availability of the required investment capital and the affordability of mobile subscriptions and services amongst the population.

- *Social factors* include demographic and cultural aspects. With regard to mobile services, the age and income distribution as well as the urban and rural population density could have an impact on the offering and usage of mobile services. This is because network infrastructures are more profitable to operate in areas with a high communication demand. Additionally, young and tech-savvy customer groups can be expected to be more open towards innovative mobile service offerings. Furthermore, cultural values and habits influence human communication and interaction. For this reason it can be expected, that cultural differences across countries might affect the usage of innovative mobile service offerings.

- *Technological factors* are related to technological advancements, rate of changes, and life-cycles. The discussion of the evolution of the mobile network technologies above has illustrated the fact that countries might differ in their individual migration path to up-to-date 3G and 4G technologies. In many developed countries, the mobile networks evolved from first, to second, to third, and finally to the recent fourth generation network technology by continuously updating and upgrading their legacy network infrastructures. In contrast, the market introduction of mobile services and the establishment of a user base in developing countries often started with the introduction of more recent technologies and thus with a more “greenfield” oriented approach. Another technological aspect is related to the availability and quality of alternative communication services and infrastructures. While most of the users in developed countries have alternative fixed broadband access, this is not true for some developing countries where fixed broadband infrastructures have never been implemented on a nationwide scale and broadband mobile Internet access is the only option. Therefore, it can



be expected that the usage of mobile services depends not only on the mobile subscriber base but also on the penetration of (fixed) Internet access.

Against this background, this paper aims to analyze country-specific characteristics influencing smartphone usage behavior. The paper is a pre-study and based on publicly available data to screen for influencing factors that could be the subject of further research. For this reason, section 2 of this paper discusses relevant research and the compilation of the dataset before the data analysis and key findings are presented in section 3. The paper concludes with a brief discussion of the study's implications for further research in section 4.

## **2. RESEARCH APPROACH**

For many years, demand and usage of telecommunication services has been the subject of scientific research (Taylor, 1994). Often the aim of this research has been to forecast market development, e.g., for planning the required network capacity and to justify the required financial investments (Fildes & Kumar, 2002). When applied to an international context, this type of research is based on the assumption that although the diffusion of the innovation started at different times, it followed the same dynamics across the countries (Islam, Fiebig, & Meade, 2002). Traditionally this kind of research has focused on time series observations that are used to estimate the parameters of diffusion models. Other research uses econometric methods to model the characteristics of telecommunication demand, e.g., by using statistical data to estimate the parameters of utility functions (Aldebert, Ivaldi, & Roucolle, 2004). A study analyzing the international diffusion of digital mobile technology considering country characteristics was conducted by Kauffman and Techatassanasoontorn (2005). In addition to the country characteristics measured by the GNP (Gross National Product) per capita and the number of fixed phone lines per one thousand inhabitants, their conceptual model considered analog as well as digital mobile phone industry characteristics and regulatory policies. Their findings suggest, that the factors influencing digital mobile phone diffusion rates vary along the growth curve. Within the early diffusion state, they showed that "...countries that have higher GNP per capita and higher analog mobile phone penetration are likely to achieve faster adoption ...". (Kauffman & Techatassanasoontorn, 2005). A more recent study on global smartphone diffusion can be found by Kakihara (2014) who used data from 2011 and 2013 to split 28 countries into six clusters with similar patterns of smartphone diffusion as a foundation for a more qualitative identification of cluster characteristics (e.g., maturing markets, leapfroggers).

This discussion of related literature makes no claim to completeness but provides a first indication of the data requirements and the complexity of analysis to be expected when analyzing factors influencing smartphone usage across countries. This complexity is compounded as smartphone usage itself can be varied, ranging from simple voice communication to mobile web browsing to the usage of those devices for sophisticated mobile applications. From this perspective, the aforementioned diffusion models and econometric models might not be appropriate, to gain a deeper understanding of the differences in smartphone usage behavior across countries. Another problem to be considered is the limited availability of consistent sets of country data. Although international institutions like the ITU (International Telecommunications Union) provide comprehensive databases of telecommunication indicators (ITU, 2015) these data sets mainly refer to the usage of standard service offerings (e.g., network access, voice, data, messaging, tariffs).

Most of the more innovative smartphone usage scenarios in the scope of the paper at hand are based on applications installed on the end user device and cannot be measured directly by the network operators. For this reason, the availability of this data relies on laborious and costly user surveys. As mentioned before, a comprehensive dataset on smartphone usage behavior across a significant number of countries is available from the Google “One Mobile Planet” study. The country report data is available for download for the year 2013 only so the datasets cannot be used for a longitudinal analysis. The country report data was consolidated and then complemented by indicators describing the macro-environment as discussed in the preceding section. For this purpose, the database of the *World Bank* (The World Bank, 2015a, 2015b) has been screened for relevant economic, social, and technical key indicators. The resulting set of indicators was then integrated in the dataset based on the observations for the year 2013. Factors describing the legal environment have not been included in this pre-study due to its more qualitative nature. In a last step, the dataset was completed by Hofstede’s data for the six dimensions of culture (Hofstede, 2015).

The indicators on smartphone usage in scope of this study are shown in Table 1. These indicators represent the proportion (per 100) of smartphone users who use the Internet in general and have ever used the listed activities. As mentioned before, this set of indicators has been extracted to reflect the broad spectrum of smartphone applications beyond traditional mobile telephony services. The data represents 45 countries and was extracted from the 2013 Google One Mobile Planet study.

**Table 1: Descriptive Statistics on Smartphone Usage Indicators (45 Countries, 2013)**

Indicators	Activities with Smartphone - Ever Used (per 100)	N	Min	Max	Mean	Standard Deviation
<b>EVBROWS</b>	Ever Browsed Internet	45	69	93	80.98	4.859
<b>EVMAIL</b>	Ever Emailed	45	65	90	78.22	5.209
<b>EVPHVI</b>	Ever Took Photo/Video	45	53	91	80.27	7.037
<b>EVGAME</b>	Ever Played Games	45	49	80	67.27	7.765
<b>EVSONE</b>	Ever Accessed Social Network	45	54	89	72.31	7.728
<b>EVBANK</b>	Ever Online Banking	45	21	65	47.96	10.877
<b>EVPURCH</b>	Ever Purchased Product	45	16	58	39.82	8.408

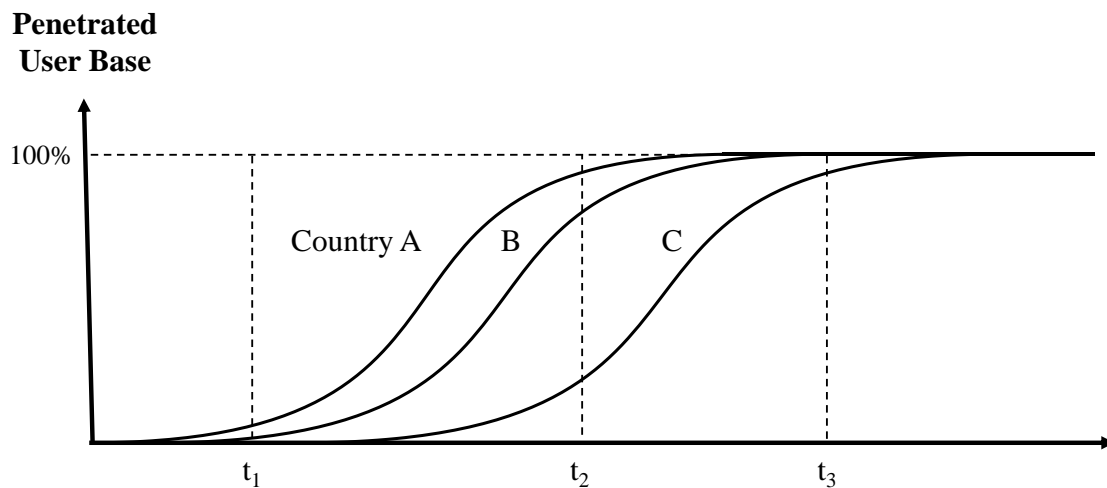
Base: Private smartphone users who use the Internet in general

Source: Analysis based on data from Google (2013)

Note: A list of the countries in scope of the study can be found here: Google (2013). Some of the countries had to be excluded from the analysis due to incomplete/inaccessible datasets (accessed 19.09.2015).

The descriptive statistics reported in Table 1 demonstrate the different levels of maturity of the corresponding activities across countries. While 81 percent have used their smartphones for web browsing less than 40 percent have ever used it for purchasing a product. Another observation from the table is, that not only the average but also the standard deviation is higher for more innovative smartphone activities. This could be due to the fact that the diffusion of innovation is typically characterized by a S-shaped growth curve as shown in Figure 3.

**Figure 3: Diffusion of Innovations across Countries**



In the early phase. i.e., at the flatter parts of the curve around  $t_1$ , only a few users are adopting the innovation. But then the diffusion curves begin to climb until the adoption rate slows down again when reaching market saturation (Rogers, 2003). If it is assumed that the diffusion of the smartphone activities across countries follow the same dynamics and started without major delays, a higher standard deviation could indicate that in many countries diffusion has reached the steep part of the growth curve around  $t_2$ . The standard deviation across countries is expected to decrease again, if most of the countries reach market saturation and thus the corresponding asymptote of the diffusion curve as indicated at  $t_3$ . However, as time series on smartphone usage are not available, differences due to differing start dates and shapes of the growth curves cannot be analyzed. As a provisional conclusion it can only be stated that the intensity of the usage of innovative smartphone applications varies across countries and that these differences seem to depend on the type or innovativeness of the respective smartphone activity.

Considering that data is available for a single year only, more information on the country specific influences could be derived from correlation analysis of smartphone activity indicators and other factors describing the macro-environments across the countries. Based on the discussion above, the following groups of indicators have been considered in this pre-study:

- *Smartphone usage indicators:* smartphone penetration (SMARTP), presence of a usage experience related to using the smartphone for Internet browsing (EVBROWS), email (EVMAIL), photo/video (EVPHVI), game playing (EVGAME), social network access (EVSONE), online banking (EVBANK), and product purchase (EVPURCH).
- *Economic indicator:* Gross domestic product per capita (GDPPC).
- *Technology indicators:* Mobile subscriptions (MOBSUB), households with a computer (HOUSPC), internet users in percent of population (INTUSR).
- *Socio-demographic indicators:* Population between 15 and 64 years (POP1564), urban population (URPOP), population density (POPDENS).
- *Cultural indicators:* Power distance (PDI), individualism (IDV), masculinity (MAS), uncertainty avoidance (UAI), long-term orientation (LTO), indulgence vs. restraint (IVR).

The complete set of indicators and the sources can be found in the appendix. Given the lack of more consistent data, inaccuracies resulting from consolidating the data from

different sources are accepted. The indicators are based on large sample sizes (e.g., the Google study is based on 500 up to 1000 respondents per country). This can be seen as advantageous compared to typical primary studies in university research. However, for the smartphone usage indicators it must be kept in mind that the data of the Google study refers to observations in the group of private smartphone users or even subgroups (e.g., smartphone users who use the Internet in general) and not the total population.

### 3. ANALYSIS AND FINDINGS

In light of the above, a first step of analysis was conducted to identify country specific influences of smartphone ownership. As discussed before, smartphones are produced and distributed on a global scale. Therefore it can be assumed, that the affordability of these devices within the total population significantly depends on the economic wealth of a nation. Smartphones enable users to access Internet services from mobile devices and rely on a developed mobile network infrastructure. Implementation of this network infrastructure often starts in urban areas. For this reason, the technology and socio-demographic indicators mentioned above have also been considered as candidate predictor variables for smartphone ownership and included in a correlation analysis. The results of the correlation analysis shows Table 2.

**Table 2: Pearson Correlations for Smartphone Penetration and Macro-Environmental Factors**

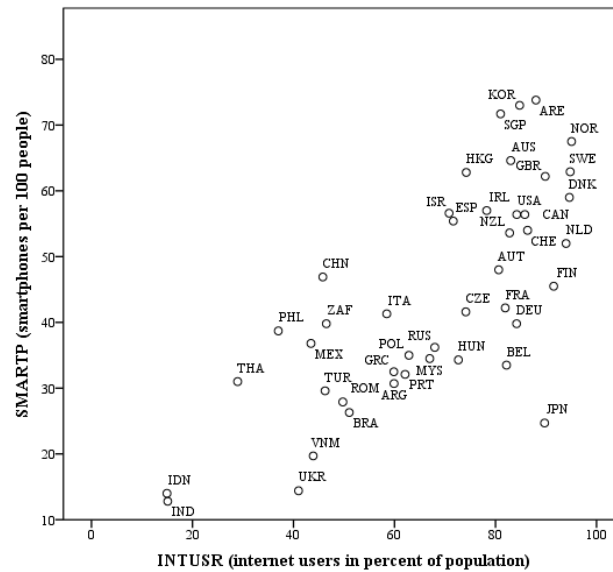
	GDPPC	MOBSUB	INTUSR	HOUSPC	POPDENS	URPOP	POP1564
Pearson Correlation	<b>0.715**</b>	0.156	<b>0.734**</b>	<b>0.700**</b>	<b>0.314*</b>	<b>0.562**</b>	0.230
<b>SMARTP</b> Sig. (2-tailed)	0.000	0.311	0.000	0.000	0.038	0.000	0.133
N	44	44	44	44	44	44	44

\*\*/\*: Correlation is significant at the 0.01/0.05 level (2-tailed).

Note: In the following correlation analysis coefficients  $\pm 0.10$  to  $\pm 0.29$  are considered weak,  $\pm 0.30$  to  $\pm 0.49$  moderate, and  $\pm 0.50$  and above as strong; Weinberg and Abramowitz (2008). The number of countries included in the analysis may vary due to the availability of the respective indicators.

According to these results, the indicator Internet users in percent of population (INTUSR) has the highest significant positive relationship to smartphone penetration. This is plausible, given that nowadays smartphones are small computers enabling ubiquitous Internet access. From this perspective the strong and highly significant correlation of smartphone penetration and the per-centage of households with a computer (HOUSPC) is also not surprising. Figure 4 shows the scatter plot of smartphone penetration and the percentage of Internet users.

**Figure 4: Scatter Plot Smartphone vs. Internet Penetration**



Additionally, and as expected smartphone penetration across countries has a strong positive and highly significant ( $p < 0.01$ ) relationship to the economic wealth indicated by the gross domestic product per capita (GDPPC). Another influencing factor of smartphone penetration has been identified by the percentage of population living in urban areas (URPOP). This relationship is again highly significant but at a lower level. This might be due to the fact that the installation of mobile network infrastructures is more profitable in urban areas with high population density and user demand as mentioned before. The average population density (POPDENS) itself has only a moderate relationship to smartphone penetration at a lower level of significance ( $p < 0.05$ ). The correlations with regard to mobile cellular subscriptions (per 100 people) and the age structure of the population are not significant. The first observation might be explained by different innovation paths. Mature markets where mobile penetration has already reached saturation might be characterized by a subscriber base with some resistant feature phones users. In contrast, developing countries have rolled out their mobile network infrastructures more recently and thus almost skipped the feature phone era by introducing broadband mobile infrastructures and smartphones directly. Regarding the age structure it can be assumed that younger generations are more open for innovative technologies but might on the other hand not possess the required purchasing power to obtain these devices. As a next step a multiple linear regression analysis was performed to test the hypothesis that the smartphone penetration across countries is a function of the Internet usage, GDP per capita, households with computers, and urban population. However, although a significant regression equation was found ( $F(4,39) = 13.617, p < 0.000$ ) with an  $R^2$  of 0.583 all the aforementioned indicators used as independent variables turned out to be not significant. This could be due to the presence of multicollinearity identified for some of the variables like INTUSR (tolerance = 0.85, VIF = 11.748) and HOUSPC (tolerance = 0.89, VIF = 11.284).<sup>13</sup> Inspection of the scatter plots also revealed that some of the relationships between smartphone penetration and the aforementioned independent variables could be affected by problems regarding the assumed linearity or heteroscedastic data (e.g., for URPOP). These problems require further research and could not be addressed in this pre-study.

<sup>13</sup> If the variance inflation factor (VIF) exceeds 10 and the tolerance is smaller than 0.10 a serious multicollinearity problem is indicated; Field (2013).

Furthermore to the aforementioned macro-environmental country indicators, the correlations of smartphone penetration and Hofstede’s cultural factors (Hofstede, Hofstede, & Minkov, 2010) were analyzed. Table 3 shows that significant moderate negative relationships of smartphone penetration across countries have been identified for power distance (PDI) and uncertainty avoidance (UAI). Consequently, countries with a more equalized distribution of power and so-cieties maintaining a more relaxed attitude toward social beliefs and behaviors tend to be associ-ated with higher levels of smartphone penetration.

**Table 3: Pearson Correlations for Smartphone Penetration and Cultural Dimensions**

	PDI	IDV	MAS	UAI	LTO	IVR
Pearson Correlation	<b>-0.443**</b>	<b>0.318*</b>	-0.204	<b>-0.366*</b>	-0.105	<b>0.329*</b>
<b>SMARTP</b> Sig. (2-tailed)	0.003	0.038	0.190	0.016	0.494	0.029
N	43	43	43	43	45	44

\*\*/\* . Correlation is significant at the 0.01/0.05 level (2-tailed).

Furthermore, significant moderate positive relationships have been identified for individualism (IDV) and indulgence (IVR). Therefore, more individualistic societies in which its members ex-hibit a higher willingness to realize their impulses and desires (i.e., enjoying live and having fun) tend to be associated with higher levels of smartphone penetration. However, it has to be consid-ered that the correlations are at a low moderate level and only the relationship to PDI showed a higher level of statistical significance ( $p < 0.01$ ) as shown in Table 3.

A next step of this pre-study comprised the analysis of relationships between smartphone activi-ties and country specific characteristics. As mentioned before, the smartphone activities in the Google study were measured amongst the group of smartphone users who use the Internet in general and not the total population. Against this background, the lack of numerous significant correlations with regards to the macro-environmental factors, as shown in Table 4, is not surpris-ing. This may be attributed to the fact that the use of single smartphone features across countries is less influenced by macro-environmental factors then smartphone ownership. In other words, if one gets hold of a smartphone with Internet access, it will be used independently from the dis-cussed macro-environmental factors. However, there are some exceptions with regards to the usage of mail and social networks as indicated by the correlations in Table 4. Experience with smartphone usage for e-mailing (EVMAIL) seems to be associated with higher GDP per capita at a moderate level. A reason could be that e-mail communication has an important role in business environments. Smartphone users in more developed countries with higher GDP per capita might therefore tend to adapt this communication behavior for private purposes. Other interesting observations are the moderate negative relationships between smartphone usage for social networks (EVSONE) and GDP per capita (GDPPC), internet usage (INTUSR), and households with PC (HOUSPC). This could again be explained with the different migration paths towards Internet usage across countries. In more developed countries with higher levels of Internet usage and computer equipment, users might have gained social network experience from fixed line networks and computer based Internet access. In such cases smartphones could be considered an additional or complementary channel for social network

access. A different behavior can be expected in countries where broadband Internet networks were introduced based on more recent mobile network infrastructures.

**Table 4: Pearson Correlations for Smartphone Activities and Macro-Environmental Factors**

	GDPPC	MOBSUB	INTUSR	HOUSPC	POPDENS	URPOP	POP1564
<b>EVBROWS</b>	-0.083	0.189	-0.149	-0.161	0.086	-0.022	-0.122
<b>EVMAIL</b>	<b>0.338*</b>	0.110	0.266	0.182	0.110	0.282	-0.264
<b>EVFOTO</b>	0.292	0.019	0.162	0.100	0.059	0.123	-0.122
<b>EVGAME</b>	-0.011	0.229	-0.179	-0.208	0.239	-0.135	0.286
<b>EVSONE</b>	<b>-0.324*</b>	0.148	<b>-0.452**</b>	<b>-0.483**</b>	0.085	-0.131	0.080
<b>EVBANK</b>	0.117	0.016	0.045	-0.004	0.061	0.079	0.086
<b>EVPURCH</b>	0.027	0.099	-0.173	-0.205	0.102	-0.108	0.155

\*\*/\*: Correlation is significant at the 0.01/0.05 level (2-tailed).

In a last step of this study the correlation of smartphone activities to Hofstede's cultural dimensions across countries have been analyzed. The results of this analysis are presented in Table 5. There are more significant relationships compared to the macro-environmental factors discussed before. But again only moderate relationships have been identified. The first observation is that there is no significant correlation between smartphone browsing (EVBROWS) and the cultural dimensions. So mobile browsing can be seen as a standard application rather independent from cultural differences across countries. Experience with smartphone usage for e-mailing (EVMAIL) is characterized by a moderate significant correlation to power distance (PDI) and indulgence (IVR). This could be explained by the device limitations of smartphones that support a simple and concise form of communication only. Such a communication might be considered as inappropriate in countries with a high level of power distance and more hierarchical social structures. However, it might be more acceptable in cultures scoring high on indulgence that can be characterized as more relaxed and tolerating a weaker control of desires and impulses.

**Table 5: Pearson Correlations for Smartphone Activities and Cultural Dimensions**

	PDI	IDV	MAS	UAI	LTO	IVR
<b>EVBROWS</b>	-0.046	-0.157	-0.006	-0.297	-0.150	0.179
<b>EVMAIL</b>	<b>-0.343*</b>	0.077	-0.143	-0.223	-0.178	<b>0.474**</b>
<b>EVPHVI</b>	-0.223	0.067	-0.233	<b>-0.325*</b>	-0.161	<b>0.321*</b>
<b>EVGAME</b>	0.145	<b>-0.332*</b>	-0.129	<b>-0.435**</b>	-0.063	0.057
<b>EVSONE</b>	0.236	<b>-0.463**</b>	-0.260	-0.196	-0.274	0.152
<b>EVBANK</b>	-0.107	0.008	<b>-0.405**</b>	<b>-0.418**</b>	<b>-0.323*</b>	<b>0.325*</b>
<b>EVPURCH</b>	0.003	-0.291	-0.121	<b>-0.429**</b>	-0.232	0.191

\*\*/\*: Correlation is significant at the 0.01/0.05 level (2-tailed).

Experience with smartphone usage for making photos and videos (EVPHVI) has a moderate negative relationship to uncertainty avoidance (UAI) but a moderate positive relationship to indulgence (IVR). This could be because a society that feels threatened by

ambiguous or unknown situations might be less inclined try or use photo or video features due to privacy concerns. The positive correlation with indulgence on the other hand could be related to the fact, that societies with higher scores on this cultural dimension are less prone to control desires and impulses, i.e., to use smartphones to spontaneously make and share photos and videos. Gaming activities (EVGAME) are characterized by moderate significant relationships to individualism (IDV) and uncertainty avoidance (UAI) across countries. In other words, greater experience with smartphone gaming is more common in collectivistic cultures and in societies where its members are less threatened by the risks that might be associated with online gaming. Similarly, smartphone based social networking (EVSONE) activities revealed a significant relationship to the cultural dimension individualism (IDV). As to be expected, a higher level of mobile social networking experience is associated with countries scoring lower in this cultural dimension, i.e., that are characterized by higher levels of collectivism. Not quite as obvious is the negative correlation between mobile banking (EVBANK) and masculinity (MAS) as well as long-term orientation (LTO). This would mean that greater experience with smartphone usage is associated with lower relevance of competition, achievement and success as well as pragmatism within a society. A reason for this could be that a more advanced banking infrastructure can be expected in countries scoring higher with regard to masculinity and long-term orientation. Additionally, the relationship between experience with smartphone banking and indulgence (IVR) is not immediately explainable. These observations would require more research to be clarified. Better in line with the expected outcome is, that high levels of uncertainty avoidance (UAI) have a moderate negative relationship to mobile banking as well as to the usage of smartphones for mobile purchasing (EVPURCH).

#### 4. CONCLUSION

This paper has analyzed country specific influences on smartphone usage behavior. Due to the lack of consistent and recent data, the study was conducted based on a consolidated dataset from different sources. The findings of the study revealed that the smartphone penetration is significantly related to factors in the macro-environment of the countries subject to this study. The factors with the strongest correlation on smartphone usage are Internet usage, GDP per capita and households with computers. With regard to Hofstede's cultural dimensions a moderate negative relationship of smartphone penetration to power distance and uncertainty avoidance as well as a moderate positive relationship to individualism and indulgence was observed across countries. Besides smartphone users' experience with e-mail and social network activities there was no significant correlation with the economic, technological and socio-demographic indicators in the scope of the study. The analysis of cultural dimensions revealed that the cultural impact varied depending on the type of the smartphone activity. As correlation does not imply causality further research is required to identify the reasons for the observed correlations and to deepen this analysis based on theoretically grounded research models. However, the results of this pre-study indicate that cross cultural studies on smartphone usage behavior could be a fruitful field for future research. The study results also stress the need for more comprehensive datasets on smartphone usage as this data could be used to gain valuable insights on the required country-specific adaptation of innovative mobile service and application offerings.



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## APPENDIX

Source	Indicator	Description
<b>(Google, 2013)</b>	EVBROWS	Ever Browsed Internet
	EVMAIL	Ever Emailed
	EVPHVI	Ever Took Photo/Video
	EVGAME	Ever Played Games
	EVSONE	Ever Accessed Social Network
	EVBANK	Ever Online Banking
	EVPURCH	Ever Purchased Product
	SMARTP	Smartphone (per 100)
<b>(The World Bank, 2015a, 2015b)</b>	GDPPC	GDP per capita (current US\$)
	POP1564	Population between 15-64
	URPOP	Urban population (% of total)
	POPDENS	Population density (people per sq. km of land area)
	HOUSPC	Households with a computer (in %)
	INTUSR	Internet users (in % of population)
	MOBSUB	Mobile cellular subscriptions (per 100 people)
<b>(Hofstede, 2015)</b>	PDI	Power Distance
	IDV	Individualism
	MAS	Masculinity
	UAI	Uncertainty Avoidance
	LTO	Long Term Orientation
	IVR	Indulgence vs. Restraint

**STANDARDIZATION VS. MODIFICATION:  
EXPLORING PERCEPTIONS AMONG THAI WOMEN OF  
JAPANESE COSMETICS ADVERTISEMENTS IN THAILAND**

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**ABSTRACT**

This study explored the differences in perceptions among Thai women towards the standardized version and the adapted version of Japanese cosmetics advertisements in terms of believability, irritation, attitude toward the ad, and intention to purchase the advertised brand. The research design was adapted from the study of Okazaki et al. (2010), which tested the effectiveness of Global Consumer Culture Positioning (GCCP) in terms of perceptions across markets. The samples for this study were 255 Thai women selected using the convenient sampling technique. An online self-administered questionnaire survey was used for the data collection. Samples were asked to watch two different versions (adapted and standardized) of television commercial films and to complete an online survey. The main findings suggested that the adapted Japanese cosmetics advertisements were perceived more positively in terms of believability, and it could be interpreted that Thai women are more likely to believe in Japanese cosmetics product or brands more when they watch advertisements adapted for Thai customers. However, the adapted version of the Japanese cosmetics advertisements somehow irritated the Thai women that watched them more than the standardized version—there was no significant difference in attitude toward the ad or purchase intention. The results of this study are relevant and challenging to cosmetic companies that target Thai customers, including marketers and advertising agencies that are involved with Japanese cosmetics advertisements, as they must try to figure out which advertising approach is appropriate for convincing Thai women.

Keywords: Thai women, Japanese cosmetics, Advertisement, Standardization, Adaptation

# **STANDARDIZATION VS. MODIFICATION: EXPLORING PERCEPTIONS AMONG THAI WOMEN OF JAPANESE COSMETICS ADVERTISEMENTS IN THAILAND**

## **1. INTRODUCTION**

Beauty and personal care in Thailand, especially regarding cosmetics, has gradually generated promising growth. As Thai consumers tend to take better care of their beauty in order to improve their image to ensure that they can obtain good career opportunities in Thai society, cosmetics have become highly demanded and have played a prominent role like other fundamental products such as foods. Consequently, competition in the cosmetics market has become intense and tougher. Both international and domestic brands must implement marketing strategies through various communication channels to enhance brand awareness, brand recognition, and to gain a greater market share. Nowadays, online marketing and advertising are carried out by a number of cosmetics manufacturers due to high penetration of the digital lifestyle, which has encourages the rise of e-commerce, social media, online bloggers, and online product research by sophisticated consumers in Thailand (Euromonitor, 2013). This fact shows the prospective growth and relevant role of online marketing and advertising in the cosmetics industry. However, traditional media such as television, magazines, newspapers, etc. are still being used to communicate and promote cosmetics products.

In 2013, skincare and hair care products in Thailand were ranked in the top 10 category of ad expenditures (Nielsen, 2013). In particular, 4 of the top 10 advertisers are large beauty and personal care companies, including Unilever (Thai) Holdings, Procter and Gamble (Thailand), L'Oréal (Thailand) Ltd., and Beiersdorf (Thailand) Co., Ltd. (Nielsen, 2013). Obviously, these top advertisers are western companies. According to Euromonitor (2013), they were also ranked among the top 10 companies in terms of market share according to value from 2008 to 2012 in Thailand. This provides some evidence about the relationship between advertising expenditure and share value. Interestingly, the advertisements of these western companies were most adapted by local agencies in Thailand.

The finding of the relationship between advertisements and share value leads to the question of why Asian cosmetics companies, particularly Japanese companies, which are supposed to have better understanding and performance in the Asian markets such as Thailand, have not been able to entirely outperform western cosmetics company in terms of market share. Could it be possible that the advertising approach is one of the factors that make Japanese companies unable to reach the top 5 in the market share in Thailand?

When closely investigating the advertisements of Japanese cosmetics in Thailand, including television commercial films (TVCFs) and print advertisements in magazines and newspapers, it can be seen that most advertisements are derived from the original Japanese version without major adaptation. Some changes that are noticeable in the Thai version of the ads are the translation of the ad contents into the Thai language. This standardization of Japanese ads may reflect the intention of the Japanese company to maintain the Japanese theme because they perceive that their target customers are Asian people like the Japanese. In addition, this approach could help reduce advertising costs (Wang & Yang, 2011). However, some advertisements of Japanese cosmetics, especially mass brands, have been adapted or

produced in Thailand by local agencies and have used Thai presenters in the advertisements.

Therefore, the objective of this research is to explore which version of television advertisements is more attractive to Thai consumers. Could adapted advertisements call the attention of Thai consumers more effectively than standardized ones? How do Thai consumers actually perceive or accept different versions of Japanese advertisements that come in different advertising styles, presenters, culture, etc.? These questions motivated the author to explore the perceptions of Thai women toward Japanese cosmetics products in terms of believability, irritation, attitude towards the ad, and purchase intention by comparing advertisements originally produced in Japan without modification (standardized version) versus those that made in Thailand (adapted version).

The results from this research are crucial for Japanese cosmetics companies that compete in the Thai market. Consequently, marketers, practitioners, as well as advertisers or managers could benefit from this research, as it can help them articulate their decisions and strategic planning for the future regarding how advertisements should be properly produced in order to appeal effectively to Thai customers. The findings from this study might reveal unexpected perceptions of Thai customers that cannot be overlooked.

## **2. BACKGROUNDS AND RESEARCH QUESTION**

### **2.1 Cultural Impacts on Advertising**

Advertising is influenced by cultural values through communication and language. Thus, in order to succeed in cross-cultural advertising, it is necessary to understand local cultures and economic factors such as income levels, and the demographic characteristics of people in that country as well (Usunier 2000; Barnes & Yamamoto 2008; Waller & Fam 2000). In addition, Fam & Grohs (2007) posited the importance of the local cultural values that are still relevant for creating successful advertisements. The media preferences are different in each country. For example, the agencies in some countries may prefer to promote cosmetics through television, whereas those in other countries would rather do well with print ads. Therefore, international advertisers may need to decentralize their media selection and adapt to local preferences (Terpstra & Sarathy, 2000).

To understand the local market's cultural values, some theories could be used for analyzing advertising content. In particular, the works of Hall (1973) and Hofstede's theory of cultural values are considered the most prominent theories in cross-cultural research. On the one hand, Hall (1973) claimed that Asia is a collectivist and high-context society that can be described as group orientated, uses non-direct confrontation, is conformist, and uses non-verbal modes of communication (Fam & Grohs, 2007). On the other hand, Hofstede (1980) identified the cultural value dimensions that have been widely used in international management and cross-cultural communication. When comparing the differences between cultures regarding the value dimensions, power distance scores are high for Asian countries. Uncertainty avoidance scores are high for Japan but lower for Chinese culture countries. Collectivism is high in Eastern countries. Masculinity is high in Japan but low in Thailand. Long-term orientation that is related to the teachings of Confucius is high in Chinese culture countries and Japan; it deals with virtue and associated values, respect for tradition, and protecting one's "face" (Punyapiroje & Morrison, 2007).

Even though Japan and Thailand are Asian countries, there are differences in terms of the cultural value dimensions that reflect the differences in the style of advertisements. For example, the high context culture of the Japanese drives the “indirectness” or soft-sell approach in Japanese advertisements. In addition, the Confucianism (long-term orientation) and collectivism of Japanese people favor harmony and negative thinking towards the hard-sell approach (De Mooij, 1998). Though Thailand was described by Hofstede as a collectivist society, there have been arguments from other researchers that there is some evidence of individualism in some subgroups of the Thai people, and that makes Thailand have a mix of collectivist and individualist culture (Phillips, 1965; Suphab, 1975; Waterman, 1984; Wichiencharoen, 1976). As a result, this may be the reason why Thai advertising is unique in terms of cultural cues (Punyapiroje, Morrison, & Hoy, 2002).

## **2.2 Advertising style: Japan vs. Thailand**

### *2.2.1 Advertising in Japan*

There has been research supporting the fact that Japanese advertisements have unique characteristics (Barnes & Yamamoto, 2008). Japanese advertisements employ a soft-sell appeal that creates good emotion or good atmosphere rather than highlighting the product and its features (Drew, 2005; Mueller, 1992). Short, clear phrases, indirect expression, and hidden meaning are viewed as trustworthy and beautiful values to the Japanese (Johansson, 1994). That makes Japanese advertisements more image-oriented and focused on telling a story or entertaining the audience (Barnes & Yamamoto, 2008) and they may not provide much about the benefits associated with price or product attributes (Nakanishi, 2002). Moreover, Johansson (1994) suggested that Japanese TVCF offers a dream, a fantasy, or an escape, which is according to the definition of the soft-sell approach, which uses beautiful scenes or the development of an emotional story; and the communication style tends to be more suggestive and indirect (Mueller, 1992).

On the other hand, from the Japanese perspective, the hard-sell approach is concerned with losing face or distrust (Doi, 1981; De Mooij, 1998). The hard-sell approach or advertising techniques have been found to be used more frequently in western advertisements (King, 2006). Western ads often use a logical approach to persuade people with facts and figures or recommendations from experts (Nakanishi, 2002). Product and brand name recommendations are clearly specified. Distinguishing the product’s advantage from that of the competition as well as product comparison are also primarily emphasized. The notion of being "number one" or the "leader" is also included in hard-sell statements, and the tone of the communication style is likely to be aggressive.

Regarding the human models used in the advertising, a the survey conducted by Barnes and Yamamoto (2008) revealed that Japanese women prefer Japanese models in cosmetics advertisements, even though the use of Caucasian models is common in Japan. This might be because western models cannot deliver a message about beauty that includes Japanese values as well as the Japanese can, although western models possess a symbol of ideal beauty.

### *2.2.2 Advertising in Thailand*

It was suggested that Thai advertising is unique compared to advertising in other Asian countries in terms of originality and creativity (Barron, 1998). Nonetheless, Thai advertising also utilizes distinctive cultural cues that make it difficult for foreigners to

understand (Punyapiroje, Morrison, & Hoy, 2002). Additionally, Thai advertising is unique in its use of imagery and creative gags because Thai consumers tend to have more lateral thinking, and that encourages a wider range of attitudes and emotions to conceive with Thai creative ideas (Sherer, 1995).

Aside from Hofstede's theory, Komin (1991) argued that Hofstede's dimensions might not capture all of the Thai cultural values. She suggested that the Thai social system is hierarchically structured and focuses on individualism and interpersonal relationships. Her study revealed that Thai people's behavior can be grouped into nine value clusters: ego, grateful relationship, smooth interpersonal relationships, flexibility and adjustment, religio-physical, education and competence, interdependence, fun and pleasure, and achievement/task orientation (Komin, 1991). In addition, Punyapiroje and Morrison (2007) used Komin's (1991) Thai value clusters to examine the cultural values in Thai advertising and found that six of Komin's nine values were used in Thai commercials. Those incorporated values are ego, fun and pleasure, achievement/task orientation, smooth interpersonal relationships, flexibility and adjustment, and grateful relationships. Particularly, the ego value was mostly used in cosmetics and personal care in Thai television commercials, which can be seen from the main character who becomes more physically attractive after using the advertised products, as ego value is concerned with physical attractiveness, and cosmetics and personal care products are normally used to improve beautiful and healthy appearance. "Ego" can be interpreted in commercials as self-esteem and status, saving face, and self-assurance, which are mostly seen in Thai TVCF.

Moreover, according to Sar and Doyle (2003), Thai advertising has become more westernized. Thais tend to have both individualistic and collectivistic natures. For example, ego and fun-related values are highly favored by Thai people and exist in all product categories (Punyapiroje & Morrison, 2007). All of the information mentioned above emphasizes the high tendency of applying the hard-sell advertising approach in Thailand.

### **2.3 Standardization Approach and Adaptation Approach**

The advertising approaches or strategies that companies going international must consider are standardization and adaptation (Wang & Yang, 2011). In terms of advertising, the standardization approach utilizes common advertising messages on an international basis. According to Mueller (1992), the standardization approach gives many benefits for the advertiser, such as cost reductions in planning and control, and the building of international brand and company image. Due to the increasing homogeneity of the world marketplace, the success of identical advertising strategies of standardized products or services, and sharing the same needs of consumers in different countries, universal advertising appeals could be utilized for promoting products or services (Buzzell, 1968). This approach helps multinational companies save advertising production costs since they could invest in standardized advertisements and apply it all around the world (Wang & Yang, 2011).

In contrast, the adaptation approach utilizes customized messages for the local market (Mueller, 1992). Kanzo and Nelson (2002) suggested that advertisers have to consider the barriers among countries, including differences in culture, preferences, foreign market media availability, industrial development, economic status, stage of the product life cycle, legal restrictions, and also the difficulties that might come about when international companies try to homogenize the differing tastes and cultures of local consumers. These barriers lead to the design of specific advertising approaches that aim to meet the cultural expectations in the

local markets.

The argument about the standardized and adapted approach in advertisements, as well as which approach would be more appropriate for communicating with the target group in each country, has been discussed in many studies (e.g., Razzouk et al., 2002). This argument was mostly discussed in cross-cultural studies between Western countries (mainly the U.S.) and Eastern countries (e.g., Japan, Korea, and China). Nonetheless, this stream of research has hardly been conducted among the countries in the Asian region (Nelson & Hye-Jin, 2007).

According to Nelson and Hye-Jin (2007), beauty products, especially cosmetics and fashion, are more likely to use the standardized approach than other types of products. Advertising elements that are widely investigated in most studies include words (e.g., headlines, body copies) and visuals (e.g., illustrations, models). Moreover, James and Hill (1991) suggested that consumers in less-developed countries regard western products as a sign of success and modernity, and they believe that the products from western countries have higher quality.

#### **2.4 Standardization vs. Adaptation: Which advertising approach receives better perception from Thai women?**

As mentioned above, advertising in Japan has its own uniqueness—the soft-sell approach—due to its high context culture and collectivism (local presenters usage), and that makes their cosmetics advertising tend to be produced by Japanese agencies in order to fit the nature of Japanese women. Consequently, those advertisements are sometimes broadcasted in other countries, especially Asian countries, without adaptation, except for language translation. In this study, this kind of advertisement is defined as the “standardized approach.”

On the other hand, this research defines the “adapted approach” as Japanese cosmetics advertisements that are produced by agencies located in Thailand, which could be foreign or Thai agencies. Most adapted advertising uses Thai presenters to offer familiarity to Thai customers and uses more direct communication for the target group. Since “ego” value is majorly illustrated in cosmetics advertising, the hard-sell approach is more likely to be used to inform Thai consumers about the benefits of a product (Punyapiroje & Morrison, 2007); that is, to enhance their beauty or appearance. In addition, as the style of adapted advertising is influenced by the western style (which focuses on unique creativity) and Thai values (which focus on fun and pleasure), flexibility, smooth relationships, and achievement could be regarded as universal and can be considered as standardized advertising that may be broadcasted in other Asian countries.

#### **Research question**

In order to examine the differences in perceptions of Thai women toward Japanese cosmetics advertisements with different advertising approaches, the research design was adapted from the study of Okazaki et al. (2010), which tested the effectiveness of Global Consumer Culture Positioning (GCCP) in terms of the perceptions of soft-sell and hard-sell appeals across markets. GCCP is a positioning strategy that seeks to differentiate a product, brand, or company as a symbol of global culture or a global market segment. The GCCP strategy was first proposed by Alden et al. (1999) as an alternative advertising strategy compared with Local Consumer Culture Positioning (LCCP) and Foreign Consumer Culture



Positioning (FCCP). GCCP was initially developed to measure the attitudes of consumers towards hard-sell and soft-sell advertisements. Since then, it has been an emerging topic in international marketing research and has been used to study the attitudes of consumers towards advertisements in various aspects (Okazaki et al., 2010; Bashar et al., 2011; Jing & Ran, 2012).

The research question is presented as follows:

RQ: Do Thai women have different attitudes towards the standardized and adapted versions of Japanese cosmetics advertisements in terms of: (a) believability, (b) irritation, (c) attitude toward the ad, and (d) intention to purchase the advertised brand?

### 3. METHODOLOGY

#### 3.1 Examples of Japanese cosmetics advertisements

In order to explore the difference in perceptions toward standardized and adapted advertisements, the TVCF of Essential Damage-Care (hair care product line of Kao Corporation) was selected from four candidates of Japanese brands. This brand was selected mainly because it broadcasted in both standardized version (using Japanese presenter) and adapted version (using Thai presenter) of TVCF in Thailand. Both versions of TVCF are presented in Picture 1.

Picture 1: Screen shots of Essential Damage-Care TVCF

Version 1-Standardized TVCF (Japanese TVCF)



Source: <http://www.youtube.com/watch?v=JBNqM0z2CM>

### Version 2- Adapted TVCF (Thai TVCF)



Source: <http://www.youtube.com/watch?v=kMjiwdUkhrA>

### 3.2 Measures

Attitude towards TVCF, including believability, irritation, attitude toward the ad, and purchase intention, were adapted from the measures proposed by Okazaki et al. (2010), which aimed to test the effectiveness of Global Consumer Culture Positioning (GCCP). The scales showed high reliability in the prior study of Okazaki et al. (2010) when they first used these scales for measuring hard-sell vs. soft-sell advertising appeals.

For the four perceptions which were dependent variables, “believability” was measured with a five-item scale (e.g., “This TVCF is convincing,” “This TVCF is credible”). The measure of “irritation” consisted of three items: “This TVCF is annoying,” “This TVCF is irritating,” and “This TVCF is disturbing.” Regarding the “attitude toward the ad” perception, it was measured with a four-item scale using the phrases “This TVCF is good,” “This TVCF is pleasant,” etc. Lastly, “intention to purchase” was measured with three items, e.g. “Would you like to try the product?” and “Can you imagine yourself buying this product?” These dependent variables were scored on a four-point scale, ranging from 1 (strongly disagree) to 4 (strongly agree).

Each version of the TVCF was coded using a dummy variable. The standardized version (Japanese TVCF) was coded 1, while the adapted version (Thai TVCF) was coded 0.

The set of control variables that were likely to affect the dependent variables were also included in the analysis. The control variables, which were demographic factors included age, education, salary, marital status and occupation, and hours of television watching per day

Age was measured in years. Education was measured using an ordinal scale ranging from 1 (less than bachelor degree), 2 (bachelor degree), 3 (master’s degree), and 4 (doctoral degree). Salary was measured using an ordinal scale ranging from 1 (less than THB 8,000), 2 (8,001-15,000), 3 (15,001-20,000), 4 (20,001-25,000), 5 (25,001-30,000), 6 (30,001-35,000), 7 (35,001-40,000) and 8 (more than 40,001). For marital status, single was coded 0 and married was coded 1. Occupation, including office employees, business owner, freelancer/part-time, housewife, student, and public servant, was measured as a dummy variable. Hours of television watching per day was measured using an ordinal scale ranging

from 1 (less than 1 hour/day), 2 (1-3 hours/day), 3 (3-6 hours/day), 4 (6-8 hours/day), 5 (8-10 hours/day), and 6 (more than 10 hours/day).

In addition, the brand loyalty of the respondents toward the current shampoo brand they used was added as a control variable since it would affect their attitude towards other brands. Brand loyalty was measured with a scale that consisted of three items, including “You prefer one brand of most products you buy” and “Usually, you care a lot about which particular brand you buy,” and “You are willing to make an effort to search for your favorite brand.” Moreover, impulsiveness was added as a control variable since people with impulsive buying behavior tend to be easily persuaded by ads. Impulsiveness was measured with a scale consisting of two items: “You often find yourself buying products on impulse” and “You often make an unplanned purchase when the urge strikes you.” The measures of brand loyalty and impulsiveness were developed by Neslin et al. (2001). These measures were scored on a four-point scale, ranging from 1 (strongly disagree) to 4 (strongly agree).

Moreover, the control variables related to background, experience, awareness, and preference that might affect attitude towards the TVCF were also included in the analysis. These factors consisted of past experience with the TVCF, the product’s country of origin, attitude towards Japanese products, attitude towards Japanese idols, and attitude towards the ad presenter.

The country of origin of the product was measured by asking if the respondents knew that the product in the TVCF was a Thai/Japanese brand. It was coded 1 if they knew and 0 otherwise. Attitude towards the Japanese product was measured by asking the respondents to rate the degree to which they personally liked Japanese products as compared to Thai products. This measure ranged from 1 (I much prefer Thai products to Japanese products), 2 (I prefer Thai products to Japanese products), 3 (I prefer Japanese products to Thai products) and 4 (I much prefer Japanese products to Thai products). Experience of watching each TVCF was measured by asking if they had ever watched TVCF. It was coded 1 if they had watched it and 0 otherwise. Attitude towards Japanese idols was measured by asking the respondents to rate the degree to which they personally liked Japanese stars, singers, and presenters as compared to Thai idols. This measure ranged from 1 (I much prefer Thai idols to Japanese idols), 2 (I prefer Thai idols to Japanese idols), 3 (I prefer Japanese idols to Thai idols), and 4 (I much prefer Japanese idols to Thai idols). Lastly, attitude toward the ad presenter was measured by asking the respondents to rate the degree to which they personally had a feeling about the ad presenter. The measure ranged from 1 (I don’t like them), 2 (I do not like them very much), 3 (I quite like them), and 4 (I like them a lot).

### **3.3 Sample, Data Collection, and Procedure**

The sample selection was based on several criteria. First, the study focused on Thai women aged between 20 and 40 that were heavy users of cosmetics. Other criteria for sample selection included: they had to make purchasing decisions by themselves, purchase their own cosmetics products, and spend their leisure time watching TV. Last, they could never have used “Essential Damage-Care” products in order to avoid past experience effects. These criteria were set to make sure that the valid samples that the author obtained would matched the objective of the study.

A self-administered questionnaire survey was used as the technique for the data collection. A pilot test and interview were conducted before the actual data collection. The

pilot test was undertaken to ensure the reliability and correctness of the questionnaire. Four appropriate participants were selected for the pilot test. At first, they were asked to complete the questionnaires and watch TVCFs both in the standardized and adapted version, and then they were asked to discuss their opinions or comments regarding the Essential Damage-Care TVCFs that they had just watched. The interview after the participants filled out the questionnaire was intentionally held in order to find out what should be improved in the questionnaires. However, the pilot study indicated that the majority of respondents tended to rate their opinion as neutral, which reflected the “neutral” tendencies of Thai people. Barnes and Yamamoto (2008) also found a cultural influence on response-scaled questions when they conducted a pilot test with Japanese respondents that tended to choose a neutral-point on the scaled questions. Consequently, they revised the questionnaire into four scaled response questions to avoid neutral tendencies. Therefore, the author decided to remove “neutral” from the five-point rating scales in order to eliminate neutral tendencies affected by cultural influence.

At first, the questionnaires were split into two versions: paper-based and online-based. For the paper-based version, the TVCFs needed to be clearly displayed to the respondents. Thus, a computer tablet was used to display the ads. To ensure that all of the respondents actually watched the TVCFs, the data collection was made face-to-face using the paper-based questionnaire. For the online-based version, the respondents could watch the VCF through the links posted in the online-questionnaire. This online-based questionnaire was convenient for data collection but there was a possibility that the respondents would skip watching the clips and randomly fill out the questionnaire. However, after testing two versions of the data collection in four pilot tests, the author found that the respondents that completed the online-based questionnaire felt more comfortable and finished it more quickly than those that filled out the paper-based survey. This was because the face-to-face approach was disturbing for the respondents, as they felt as though the author was keeping an eye on them when they watched the clips and filled out the questionnaire. Finally, the author decided to use only the online-based questionnaire in order to conduct the study smoothly. The convenient sampling technique was used for this study. The online-based questionnaires were circulated and shared via e-mail and Facebook to possible participants such as friends, colleagues, relatives, and they were asked to share or forward the online-based questionnaires to others. The author also posted the online-based questionnaires on the Facebook group pages that the author was a member of, such as the Chulalongkorn University Arts Alumni Members Group, Ramkhamhaeng University Alumni Members, and the Writer & Translator Group. This sampling was aimed to spread the questionnaires more widely to other groups. In order to encourage all of the participants to fill out the questionnaires, the author sent incentives—samples of facial gel and BB cream—to those that had completed the questionnaires and that had mentioned their name and address for mailing.

Once the respondents agreed to participate in the study, the screening questions were asked to ensure that they were qualified as a target group. They were asked to indicate their age and whether they had ever used Essential Damage-Care products. Some target individuals were rejected as they had used that brand. When they passed the screening questions, they were asked to complete the questionnaires.

After around one month, a total of 260 samples was obtained. However, 5 of samples were not completely answered, making the usable survey total 255.

The characteristics of the respondents were reported as follows. The average age of

the respondents was 30.48 years (standard deviation = 5.733). One hundred and five respondents were single (76.5%), while 60 were married (23.5%). In terms of educational background, 26 respondents held a degree lower than a bachelor degree (10.2%), 157 held bachelor degrees (61.6%), 71 held a master degree (27.8%), and only 1 respondent held a doctoral degree (0.4%). The salary of the respondents was divided into 8 groups: 31 respondents had a salary less than THB 8,000 (12.2%), 32 with 8,001-15,000 baht (12.5%), 43 with 15,001-20,000 baht (16.9%), 29 with 20,001-25,000 baht (11.4%), 21 with 25,001-30,000 baht (8.2%), 30 with 30,001-35,000 baht (11.8%), 12 with 35,001-40,000 baht (4.7%), and 57 had a salary of more than THB 40,001 (22.4%). The time that the respondents spent watching TV was divided into 6 phases: 65 respondents watched TV less than 1 hour per one day (25.5%), 108 watched TV 1-3 hours per day (42.4%), 68 watched TV 3-6 hours per day (26.7%), 12 watched TV 6-8 hours per day, no respondent watched TV 8-10 hours per day (0%), and 2 respondents spent more than 10 hours watching TV per one day.

### 3.4 Estimating technique

The Statistical Package for the Social Sciences program (SPSS) was used in this study. Descriptive statistics, correlation, and regression analysis were applied to test the hypotheses.

## 4. RESULTS

Since some of the measures consisted of multiple items, construct reliabilities were first evaluated by using Cronbach alphas ( $\alpha$ ), which is a measure of internal consistency. In brief, this coefficient of reliability or consistency is used for measuring how closely related a set of items are as a group (Cronbach, 1951). In this study, Cronbach alphas ( $\alpha$ ) were estimated for believability, irritation, attitude toward the ad, purchase intention, current brand loyalty, and impulsiveness. The results are shown in table 1. All of the values exceeded the recommended minimum value of 0.7, which indicates good reliability (Fornell & Larcker, 1981).

**Table 1: Cronbach alphas ( $\alpha$ )**

<b>BELIEVE</b>	<b>IRRI</b>	<b>ATTI</b>	<b>INTENT</b>	<b>LOYAL</b>	<b>IMPULSE</b>
0.873	0.931	0.871	0.919	0.795	0.817

BELIEVE = believability;  
 IRRI = irritation;  
 ATTI = attitude toward the ad  
 INTENT = purchase Intention  
 LOYAL = current brand loyalty;  
 IMPULSE = impulsiveness.

**Table 2: Correlations among variables**

	BELIEVE	IRRI	ATTI	INTENT	AD_JPTH
BELIEVE	<b>(1.000)</b>				
IRRI	-.276**	<b>(1.000)</b>			
ATTI	.688**	-.502**	<b>(1.000)</b>		
INTENT	.557**	-.361**	.663**	<b>(1.000)</b>	
AD_JPTH	-.067	-.092*	.025	.008	<b>(1.000)</b>

Notes: \*p<.05; \*\*p<.01.

BELIEVE= believability; IRRI=irritation; ATTI=attitude toward the ad;  
 INTENT=purchase Intention; AD\_JPTH=Japanese/Thai TVCF dummy variable  
 (Japanese=1).

Before the performing the regression analysis, correlations among variables were estimated and the results are shown in table 2.

**Table 3: Regression Analysis for Believability as the dependent variable**

Variables:	Beta (B)	Sig. (P)	VIF
<b>(Constant)</b>	1.185	<.001	
<b>Japanese/Thai TVCF (Japanese=1)</b>	<b>-.073</b>	<b>.038</b>	1.003
<b>Age</b>	-.001	.819	2.141
<b>Education</b>	<b>-.114</b>	<b>.001</b>	1.367
<b>Salary</b>	-.012	.290	2.396
<b>Marital status (married=1)</b>	.005	.912	1.225
<b>TV watching hours per day</b>	.012	.589	1.205
<b>Ever watched this TVCF</b>	.042	.263	1.066
<b>Attitude towards the ad presenter</b>	<b>.362</b>	<b>&lt;.001</b>	1.043
<b>Attitude towards Japanese products</b>	<b>.093</b>	<b>.007</b>	1.241
<b>Know country of origin</b>	.014	.659	1.069
<b>Attitude towards Japanese idols</b>	.041	.145	1.119
<b>Current brand loyalty</b>	<b>.080</b>	<b>.009</b>	1.066
<b>Impulsiveness</b>	.035	.173	1.165
<b>Occupation: -business owner</b>	.065	.287	1.112
<b>Occupation: freelancer/part-time</b>	<b>.203</b>	<b>.004</b>	1.197
<b>Occupation: housewife</b>	-.288	.107	1.190
<b>Occupation: student</b>	-.032	.631	1.870
<b>Occupation: public servant</b>	<b>.195</b>	<b>.019</b>	1.138
<b>R-square</b>		<b>.304</b>	
<b>Adjusted r-square</b>		<b>.278</b>	
<b>Number of observation</b>		<b>510</b>	

Note: \*P <.05

Table 3 reports the results from the model, in which believability was the dependent variable. The negative beta coefficient ( $\beta=-.073$ ) indicates that Japanese TVCF was perceived

lower than Thai TVCF in terms of believability. This beta coefficient was also significant at below 5 percent ( $p=.038$ ), suggesting that the difference in perception was statistically supported.

Regarding the significant associations between other independent variables, believability was positively associated with attitude towards the ad presenter ( $\beta=.362$ ;  $p<.05$ ), attitude towards Japanese product ( $\beta=.093$ ;  $p<.05$ ), current brand loyalty ( $\beta=.080$ ;  $p<.05$ ), freelancer/part-time dummy variable ( $\beta=.203$ ;  $p<.05$ ), and the public servant dummy variable ( $\beta=.195$ ;  $p<.05$ ), and negatively associated with education ( $\beta=-.114$ ;  $p<.05$ ).

For the r-squared coefficients, the results showed that the r-squared of the regression model was 0.304. This indicated that the weighted combination of the predictor variables explained approximately 30.4 percent of the variance of believability.

The variance inflation factor (VIF) was used as an indicator of the multicollinearity in the model. All of the variables ranged from 1.003 to 2.396, which were lower than the maximum requirement of 10 as suggested by Hair et al. (1995).

**Table 4: Regression Analysis for Irritation as the dependent variable**

Variables	Beta (B)	Sig. (P)	VIF
(Constant)	2.226	<.001	
Japanese/Thai TVCF (Japanese=1)	<b>-.092</b>	<b>.033</b>	1.003
Age	.008	.157	2.141
Education	<b>.100</b>	<b>.017</b>	1.367
Salary	-.007	.612	2.396
Marital status (married=1)	<b>-.154</b>	<b>.006</b>	1.225
TV watching hours per day	<b>.068</b>	<b>.009</b>	1.205
Ever watched this TVCF	-.015	.745	1.066
Attitude towards the ad presenter	<b>-.385</b>	<b>&lt;.001</b>	1.043
Attitude towards Japanese products	.048	.246	1.241
Know country of origin	.009	.814	1.069
Attitude towards Japanese idols	.022	.506	1.119
Current brand loyalty	<b>.084</b>	<b>.022</b>	1.066
Impulsiveness	-.038	.227	1.165
Occupation: -business owner	-.076	.300	1.112
Occupation: freelancer/part-time	<b>-.190</b>	<b>.026</b>	1.197
Occupation: housewife	<b>.439</b>	<b>.044</b>	1.190
Occupation: student	-.187	.535	1.870
Occupation: public servant	-.144	.153	1.138
<b>R-square</b>			
		<b>.260</b>	
<b>Adjusted r-square</b>			
		<b>.233</b>	
<b>Number of observation</b>			
		<b>510</b>	

Note: \* $P <.05$

Table 4 reports the results from the model, in which irritation was the dependent variable. The negative beta coefficient ( $\beta=-.092$ ) indicates that Japanese TVCF was perceived lower than Thai TVCF in terms of irritation. This beta coefficient was also significant at below 5 percent ( $p=.033$ ), suggesting that the difference in perception was statistically supported.

For the significant associations between other independent variables, irritation was positively associated with education ( $\beta=.100$ ;  $p<.05$ ), TV watching hours per day ( $\beta=.068$ ;  $p<.05$ ), current brand loyalty ( $\beta=.084$ ;  $p<.05$ ), and the housewife dummy variable ( $\beta=.439$ ;  $p<.05$ ). On the other hand, irritation was negatively associated with marital status ( $\beta=-.154$ ;  $p<.05$ ), attitude towards the ad presenter ( $\beta=-.385$ ;  $p<.05$ ), and the freelancer/part-time dummy variable ( $\beta=-.190$ ;  $p<.05$ ).

Regarding the r-squared coefficients, the results showed that the r-squared of the regression model was 0.260. It could be interpreted that the weighted combination of the predictor variables explained approximately 26 percent of the variance of irritation.

The variance inflation factor (VIF) was used as an indicator of the multicollinearity in the model. All of the variables ranged from 1.003 to 2.396, which were lower than the maximum requirement of 10 as suggested by Hair et al. (1995).

Table 5 reports the results from the model, in which attitude toward the ad was the dependent variable. The positive beta coefficient ( $\beta=.014$ ) indicates that Japanese TVCF was perceived higher than Thai TVCF in terms of attitude toward the ad. However, this beta coefficient was not statistically significant ( $p=.670$ ), suggesting that the difference in perception was not statistically supported.

For the significant associations between the other independent variables, irritation was positively associated with attitude towards the ad presenter ( $\beta=.496$ ;  $p<.05$ ) and the freelancer/part-time dummy variable ( $\beta=.211$ ;  $p<.05$ ), and negatively associated with education ( $\beta=-.076$ ;  $p<.05$ ).

For the r-squared coefficients, the results showed that the r-squared of the regression model was 0.427. It could be interpreted that the weighted combination of the predictor variables explained approximately 42.7 percent of the variance of attitude toward the ad.

The variance inflation factor (VIF) was used as an indicator of the multicollinearity in the model. All of the variables ranged from 1.003 to 2.396, which were lower than the maximum requirement of 10 as suggested by Hair et al. (1995).



**Table 5: Regression Analysis for Attitude toward the Ad as the dependent variable**

Variables	Beta (B)	Sig. (P)	VIF
(Constant)	1.711	<.001	
Japanese/Thai TVCF (Japanese=1)	.014	.670	1.003
Age	-.005	.223	2.141
Education	<b>-.076</b>	<b>.018</b>	1.367
Salary	-.009	.369	2.396
Marital status (married=1)	-.004	.918	1.225
TV watching hours per day	.004	.845	1.205
Ever watched this TVCF	-.025	.483	1.066
Attitude towards the ad presenter	<b>.496</b>	<b>&lt;.001</b>	1.043
Attitude towards Japanese products	.002	.940	1.241
Know country of origin	-.032	.298	1.069
Attitude towards Japanese idols	.022	.390	1.119
Current brand loyalty	-.041	.150	1.066
Impulsiveness	.043	.072	1.165
Occupation: -business owner	.090	.113	1.112
Occupation: freelancer/part-time	<b>.211</b>	<b>.001</b>	1.197
Occupation: housewife	-.178	.287	1.190
Occupation: student	-.023	.716	1.870
Occupation: public servant	.144	.064	1.138
<b>R-square</b>			
		<b>.427</b>	
<b>Adjusted r-square</b>			
		<b>.406</b>	
<b>Number of observation</b>			
		<b>510</b>	

Note: \*P <.05

Table 6 reports the results from the model, in which purchase intention as the dependent variable. The positive beta coefficient ( $\beta=.003$ ) indicates that Japanese TVCF was perceived higher than Thai TVCF in terms of purchase intention. Nevertheless, this beta coefficient was not statistically significant ( $p=.938$ ), suggesting that the difference in perception was not statistically supported.

For the significant associations between the other independent variables, purchase intention was positively associated with TV watching hours per day ( $\beta=.052$ ;  $p<.05$ ), attitude towards the ad presenter ( $\beta=.422$ ;  $p<.05$ ), and impulsiveness ( $\beta=.101$ ;  $p<.05$ ). On the other hand, purchase intention was negatively associated with education ( $\beta=-.129$ ;  $p<.05$ ), salary ( $\beta=-.043$ ;  $p<.05$ ), and current brand loyalty ( $\beta=-.140$ ;  $p<.05$ ).

**Table 6: Regression Analysis for Purchase Intention as the dependent variable**

Variables	Beta (B)	Sig. (P)	VIF
(Constant)	1.831	<.001	
Japanese/Thai TVCF (Japanese=1)	.003	.938	1.003
Age	.002	.679	2.141
Education	<b>-.129</b>	<b>.002</b>	1.367
Salary	<b>-.043</b>	<b>.002</b>	2.396
Marital status (married=1)	.003	.962	1.225
TV watching hours per day	<b>.052</b>	<b>.047</b>	1.205
Ever watched this TVCF	-.081	.078	1.066
Attitude towards the ad presenter	<b>.422</b>	<b>&lt;.001</b>	1.043
Attitude towards Japanese products	.031	.457	1.241
Know country of origin	-.007	.869	1.069
Attitude towards Japanese idols	.037	.273	1.119
Current brand loyalty	<b>-.140</b>	<b>&lt;.001</b>	1.066
Impulsiveness	<b>.101</b>	<b>.001</b>	1.165
Occupation: business owner	.052	.483	1.112
Occupation: freelancer/part-time	.094	.274	1.197
Occupation: housewife	-.345	.114	1.190
Occupation: student	-.050	.539	1.870
Occupation: public servant	.050	.623	1.138
<b>R-square</b>			
		<b>.327</b>	
<b>Adjusted r-square</b>			
		<b>.302</b>	
<b>Number of observation</b>			
		<b>510</b>	

Note: \* P <.05

Regarding the r-squared coefficients, the results showed that the r-squared of the regression model was 0.327. The weighted combination of the predictor variables explained approximately 32.7 percent of the variance of purchase intention.

The variance inflation factor (VIF) was used as an indicator of the multicollinearity in the model. All of the variables ranged from 1.003 to 2.396, which were lower than the maximum requirement of 10 as suggested by Hair et al. (1995).

## 5. DISCUSSION

### General discussion

This study was conducted to test and explore the perceptions among Thai women towards standardized and adapted Japanese cosmetics advertisements broadcasted in Thailand. Table 7 below summarizes the results from the regression analysis for four perceptions.

**Table 7: Results from Regression Analysis of Four Perceptions**

<b>Believability</b>	<b>Japanese TVCF &lt; Thai TVCF</b>	<b>Statistically significant</b>
<b>Irritation</b>	<b>Japanese TVCF &lt; Thai TVCF</b>	<b>Statistically significant</b>
Attitude toward the ad	Japanese TVCF > Thai TVCF	Not statistically significant
Purchase intention	Japanese TVCF > Thai TVCF	Not statistically significant

The first perception, believability, showed that Thai women would likely believe in Japanese cosmetics advertisements with adaptations that used Thai presenters more than standardized versions. For the next perception, irritation, the results suggested that Thai women became irritated when watching adapted cosmetics advertisements more than the standardized ones. Regarding the perception “attitude toward the ad,” it showed that Thai women had a positive attitude toward Japanese cosmetics advertisements that used Japanese presenters more than adapted versions. Lastly, regarding purchase intention, the results suggested that Thai women were likely to have more intention to purchase Japanese cosmetics products when they watched advertisements with standardization. However, the differences in attitude toward the ad and purchase intention were not statistically supported in this study.

In summary, adapted Japanese cosmetics advertisements were perceived better in terms of believability. This means that Thai women believe in Japanese cosmetics products or brands more when they watch advertisements especially made for Thai customers. This finding was consistent with the information from the interview with the respondents during pilot test. They suggested that the adapted TVCF was more convincing since the presenters were well known, while the standardized TVCF was represented by unknown Japanese presenters, so they did not feel any involvement. Moreover, the atmosphere or tone of the TVCF was more familiar, more real, and closer to the Thai customers. Nevertheless, the adapted version somehow irritated the Thai women that watched the advertisements. Some participants in the pilot test also expressed irritation when they watched the Thai TVCF. They mentioned that the adapted TVCF was too over-claimed compared to the standardized TVCF; and some said that they personally did not like some of the presenters in the adapted TVCF but had no problem with the Japanese presenters in the standardized TVCF, as they did not know who they were.

The results from this research, showing that adapted advertisements were positively perceived in terms of believability, are consistent with results revealing that brand personality is positively related to a more adaptive approach by firms (Wang & Yang, 2011). Brand personality is positively associated with consumer preferences such as trust, loyalty, and confidence in consumers’ minds, while believability is related to truth, credibility, and acceptance. The author does not intend to communicate that they are the same type of variable, but that they are both positive preferences that customers look for. Further, these results showed that the adapted advertising approach could be used for enhancing brand personality or believability in the local market. Aside from that, the result suggesting that adapted advertisements irritated the Thai women that watched cosmetics advertisements is also an interesting point to study in terms of the reasons why adapted advertisements were perceived as irritating, annoying, and disturbing even though the advertisements were specifically designed for the local market.

## **Limitations**

The limitations of this study are the following. First of all, the author used the convenient sampling technique which might not guarantee that the samples were randomly selected; and this limitation might have caused a sampling error. Secondly, the online survey that was used for convenience and for the comfort of the respondents could not ensure that all of the respondents really watched the TVCF. Thirdly, this research did not control the resident area of the respondents so the study could not reflect the different perceptions between the Thai women that lived in Bangkok and those that lived in rural areas. These limitations should be paid more attention to in future study.

Fourthly, only the TVCF was used as the advertising medium for this research. Magazine advertisements should have been used for testing the perceptions, as they are another influential medium for cosmetics advertising. The author actually wanted to use magazine advertisements for this research but due to the lack of examples; Japanese Cosmetics Company only published either standardized version or adapted one on Thai magazine, no one used both approaches. Therefore, the author decided to eliminate magazine advertisements for testing the perceptions in this research. Lastly, only a single brand was used for testing the perceptions even though there are numbers of Japanese cosmetics brands in the Thai market. Due to the limitation of appropriate advertisements at that time, only Kao's Essential Damage-care was selected since it was the most appropriate advertisement for the study. However, the author believes that these two limitations could be solved in future study if appropriate advertisements can be found.

## **Practical implications**

The results of this study are relevant to cosmetic companies that target Thai customers, including marketers and advertising agencies that are involved with Japanese cosmetics advertisements. Especially, the results suggest that adapted versions of advertisements were positively perceived in terms of believability among Thai women. At the same time, however, Thai customers became irritated when they watched the adapted version. These are challenges that people that are involved in this industry must face; that is, which advertisement approach is most appropriate for convincing Thai women. Adapted advertisements could be more believable but cost a lot to produce, while standardized advertisements might have less believability but may not irritate Thai customers. The presenters also impacted the perceptions as well as Japanese product preferences. In addition, the results suggest that advertisements positively impacted those that had a lower educational level, a lower salary, had more time to watch TV, including those that work as freelancers and part-time. Therefore it can be interpreted that the TVCF worked well for particular groups. To penetrate some groups, it is highly recommended to have additional studies of the perceptions among Thai women separating the target groups, for example, "mass Japanese cosmetics advertisements" and "premium Japanese cosmetics advertisements", etc.

## **6. CONCLUSION**

This study explored the difference in perceptions among Thai women towards Japanese cosmetics advertisements in Thailand from various perspectives. The findings from the study showed that adapted Japanese cosmetics advertisements were perceived better in terms of believability, where it could be interpreted that Thai women are likely to believe in

Japanese cosmetics products or brands more when they watch advertisements especially produced for Thai customers. However, the adapted version of the Japanese cosmetics advertisements irritated the Thai women that watched the advertisements more than the standardized version. Thus, standardized and adapted advertising approaches both have pros and cons, depending on how marketers or practitioners consider how the advertisement should be properly produced in order to appeal effectively to Thai customers. It is not just the advertising approach that they should focus on, but they should also focus on the culture and other characteristics of Thai customers in order to have a better understanding about their attitude and preferences.

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**THE CONTRIBUTION OF MANAGERIAL TIES TO INTERNATIONAL  
LEARNING CAPABILITY AND EXPORT PERFORMANCE: EVIDENCE FROM  
THAI EXPORTERS**

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**ABSTRACT**

This study empirically investigates the role of managerial ties that facilitates the acquisition of international learning capability, which consequently benefits export performance. Social capital theory and resource-based view of firm are used as the main theoretical framework for hypotheses development. A survey data were collected from 124 export firms in Thailand. The data were analyzed using partial least square regression analysis. The results suggest positive relationship between managerial ties and the international learning capability, which in turn, positively associated with the export performance of the sample firms. The results also support the positive and direct association between managerial ties and export performance. The overall results imply that Thai export firms may be able to develop their international learning capability which is crucial to improve their export performance by cultivating the benefits from their social capital. .

Keywords: export, international learning capability, managerial ties, social capital, research-based view of firm



# **THE CONTRIBUTION OF MANAGERIAL TIES TO INTERNATIONAL LEARNING CAPABILITY AND EXPORT PERFORMANCE: EVIDENCE FROM THAI EXPORTERS**

## **1. INTRODUCTION**

As we are living in the ever fastest changing world of fierce business competition, and as more business firms are trying to expand their promising business oversea by either exporting, direct foreign investment, or joint venture according to Fabling & Sanderson, (2013), it is essential for those firms to develop new or adapt their strategies to the kind of environment where their businesses reside. However, this may not be an easy task to accomplish instantly. It is generally required more than just a moderate planning, organizing, leading, and controlling. According to Colin & Xu (2010), there are many obstacles that firms need to be aware and able to overcome first, before many of them can reach their expectations and execute the ultimate goals. First and foremost, in order to strengthen and streamline their business strategies, firms must understand about the livelihood of their business environment, background, institution, consumers' taste, and etc. More importantly, firms ought to acquire additional knowledge through some certain means and improve their learning capability in order to come up with innovative, up to date, and new and attractive products to the markets to compete successfully in both domestic and international markets according to Mat & Razak (2011).

An important indicator of success of a business firm is its learning and capability development which, encompasses all firms' activities focused on: (1) improving the performance of groups and individuals within the organization by stating the gaps in skills, competencies, and knowledge; and, (2) creating the strategic talent capabilities of the firm through a systematic aim on competence that is required to meet business goals (Thai-ngam & Vathanophas, 2007). This usually includes learning strategy, content design and development, audience assessment, learning programs, learning culture, measurement and evaluation (Mallon, 2010). Nevertheless, there are some milestones that firms may have to overcome before they can achieve or gain access to the new knowledge as above mentioned and enhance their learning capability.

Some previous research defines learning capability as the managerial and organizational characteristics, skills, practices, or the organizational learning processes facilitators (e.g., integrating information/knowledge, generating, disseminating, and acquiring), which allows an organization to learn (Jerez-Gomez et al., 2005). The rapidly changing business condition has induced researchers and managers to search for new ways to streamline firms' capability of predicting the need for capability of continuous adaptation and change. Firms' learning boosts continuous adaptation and improvement of organization as a whole. Whereby, firms' learning has comprised the endeavor of managers seeking to survive their current business environment (Goh & Richards, 1997). Clark & Wheelright (1992) recommend that learning capability is the peculiar factor in new product development of firms. This is because new product must make improvement and adapt to the current fast changing situations such as, technological developments, customer demand uncertainty, and competitive market situations.

Prior research found that learning capability can be generated from many sources. For

example: Interaction and openness with the external environment, which is considered as a climate of openness that encourages the points of views and new ideas by extensive relationships with the external environment (Chiva et al., 2007); Knowledge transfer and integration, which comprises of two closely related processes: internal transfer and integration of knowledge, happens simultaneously rather than sequentially. The capableness of these two processes depends on the previous existence of absorptive capacity suggesting the minimal degree of internal barriers that hinder the transfer of firms' best practices (Cohen & Levinthal, 1990); And managerial commitment implies that managers acknowledge the relevance of learning for firms' success in which they create a culture that reinforces the, creation, acquisition, and knowledge transfer as fundamental values (Jerez-Gomez et al., 2005).

In addition to the sources of learning capability mentioned earlier, research suggests that social capital is also another mean by which learning capability can be gained (Wever, 2008). Social Capital is a concept where relationships and norms shape the quality and quantity of society's social interaction (Acquaah, 2007). It is about having good network by building relationships purposefully and incorporating them to create intangible and tangible short and long-term benefits, (Armstrong & Shimizu, 2007; Barney, 1986; Heath & Peng (1996); Mahoney & Pandian, 1992; Peteraf, 1993),. Many managers today strive for new connection and ties. It is believed that social relations derived from social capital have potential to facilitate the increase of economic benefits to business firms (Bazan and Schmitz, 1997; Behyan el at., 2011; Peng, 2000; Yeung & Tung 1996;). In the Eastern cultures, especially Thailand, it is assumed that in order to become successful in business it is important for firms to have strong relationships with the stakeholders, whether it is suppliers, customers, or outside institutions (Baron & Nambisan, 2010; Ebner et al., 2009; Lilien et al., 2002; Poppo & Zhou, 2008). Not only they must by pass some regulations, but also knowledge sharing becomes essential (Lages et al., 2009; Narayan & Woolcock, 2000).

The main objective of this research is to focus on the benefit of social capital of Thai exporting firms on their export performance. One of the significant aspects of social capital which this research focuses on and is the main interest is managerial ties. In this context, managerial ties are an important driver to facilitate the management of favors (Dunlap et al., 2013), primary consisting of relationships or connections between upper level personals of one's firm and other related firms that have positive influences on firm's performance. This research deploys social capital theory to explain the contribution of managerial ties on international performance of Thai exporters (Acquaah, 2007; Bazan & Schmitz, 1997; Danis et al., 2010; Estrin & Prevezer, 2011; Heath & Peng, 1996; Li et al., 2008; Luo & Peng, 2000; McCarthy et al, 2013; Peng, 2003; Poppo & Yang , 2008). Specifically, the author argues that managerial ties can enhance international performance through the mediating effect of international learning capability. The author posits that knowledge gained from social connections with other managers at different firms would give them knowledge that they sometimes they cannot find themselves. Moreover, the resourced-based view (RBV) of the firm (Barney, 1991) will be used as another theoretical support to explain why managerial ties can be considered a critical resource that firms can use to build their competitive advantage.

Although research about the role of social capital on firm performance has been investigated in research (Bazan & Schmitz, 1997; Behyan el at., 2011; Heath & Peng 1996; Heslam, 2009; Peng 2000; Tung & Yeung, 1996; Sari, 2008; Stam 2013), study conducted using the sample of Thai firms is still lacking. The sample of Thai firms can provide more

understand about the role of social capital in business as Thai firms are based in the country where social connections are considered as vital source for the survival and growth of firms (Stam et.al., 2013).

This research will begin by examining the definition of export performance and how it can be used as a powerful index to measure a firm's success. It will then explain about social capital of firms and the way it has a significant influence on firm's outcome of success. It will explore the linkage between social capital among the top managers and degree of competitiveness gained by the firms in adopting criteria in the resourced based view. Then, it will explore how managerial ties would increase firms' learning capability and export performance.

## **2. LITERATURE REVIEW AND HYPOTHESES**

### **2.1 Export Performance**

Export performance is the success or failure of the efforts of an enterprise to sell domestic produced goods and services in other countries or nations (Zou and Stan, 1998). Export performance is usually explained in objective terms such as sales, profitability, or marketing measures and in subjective measures such as customer satisfaction (Oliveira et al., 2012). Over the last few decades, many companies from developing countries have started to expand from domestic market to international markets by selling their product to international customers through the means of exporting (Zou and Stan, 1998). However, firms face high degree of uncertainty when they are deciding how to serve foreign and international markets. Often times, they are not aware of the local legal requirements or regulations in obtaining the operating licenses. They are sometimes unsure about how adequate their products are to the local customer tastes and the size of international demand (Aaby and Slater, 1989). Therefore, firms are likely to export more than other mode of expansion such as FDI, franchising, and licensing (Conconi, Sapir, and Zanardi 2014). Some of the advantages of exporting are that firms can sell their goods and services to the markets that it had never before sold to, which will boost their sales and increases revenues for firms. Firms could gain some part of the global market shares, (Moini, 1995). By exporting, firms could gain some part of their share in large international market place and participate in the global market (Cavusgil and Kirpalani, 1993). They can gain new knowledge and experience. By exporting or going international firms can gain new ideas and valuable information about recent technologies, new marketing strategies and techniques, and outside competitors through social networks. The gains could help firms' performance domestically as well as internationally (Lages, 2000).

In research, the topic of export performance of firms has been studied extensively. Some of the early researches on the firm's export performance can be retrieved back to the beginning of 1960s by Tookey (1964), whose work was the pioneer. He tried to point out factors that lead to the successes of exporting. Since that time, several empirical studies have identified and examined the major determinants of export performance, showed that there are increasing global interests in exporting (Bilkey 1978; Cavusgil and Nevin, 1981; Reid, 1983; Madsen, 1987; Aaby and Slater, 1989; Moini, 1995; Johanson & Vahlne, 1977; Cicic et al, 2002; Bijmolt and Zwart, 1994; Walters and Samiee, 1990; Da Rocha and Christensen, 1994). Literatures in this area also suggested that export performance can depend on various factors. Some of these factors include resource availability, marketing strategy,

organizational structure, managerial experience, and etc (Dijk, 2002; Zou (1994); Hawawin et al, 2003; McGahan and Porter, 1997; Hill and Deeds, 1996; Porter, 1985; Pearce et al, 1987) attempted to conceive the dynamics of the interrelationships, which proposes a basic working model that consisted of three groups of variables: *background*, which is environmental forces, organizational, and managerial that have an indirect affect to export performance; *intervening*, that is the variables that have a direct affect to export performance, consisting mostly of targeting elements and marketing strategy; and *outcome*, which is the export performance of firms. This model serves as a fundamental framework for the present study. The author focuses on the managerial factor which can be conceptualized in terms of the demographic, behavioral, experiential, attitudinal, and other important characteristics of a decision maker who is normally involved within the exporting processes of a firm (Leonidou et al. 1998). Specifically, this research emphasize on the capability of managers to develop social ties with managers at other firms that allow them to enhance their export performance.

## 2.2 Social capital theory

This research is based largely on social capital theory. Social capital is a concept that has existed since the formation of small communities and human were interacting with such an expectation of trust and reciprocation (Bazan and Schmitz, 1997). Social capital theory consists of the norms and networks that facilitate cooperative or collective actions for the mutual benefits. At one end, social capital theory is based on the premise that social relationships have the ability to facilitate the accrual of economic benefits to the individuals and the group (Yeung & Tung 1996). The relationships shape and connect the links of interactions and communications. Generally, a society that is endowed with such valuable and diverse stocks of social networking will be in a better and less vulnerable position from the attack of asperity. In addition, it will be in the stronger position to dissolve disputes and/or take advantage of the new opportunities (Sari, 2008). In the opposite, the absence of social ties or social networks can have the significant impacts. For example, in the times of need, a community may not be able to lend a helping hand if it does not have any connections with other outside neighboring communities (Heslam, 2009).

The conceptualization of social capital was formally acquired in community studies to explain relational resources rooted in personal connections within the community (Behyan et al., 2011). For example, open innovation instruments, such as IT-based open innovation platforms (Ebner, Leimeister & Krcmar, 2009; Nambisan & Baron, 2010) or lead user workshops (Lilien et al., 2002), foster interaction, where managers establish or strengthen social relationships and hence subsequently create a constructive social network across organizational boundaries. Such networks are beneficial as they later may provide passage ways to ideas, knowledge and other resources (Lages et al., 2009). Despite the proliferation in the internet recruitment services, majority of employers are still looking for the right people for the job, and most jobseekers find the best jobs they are looking for by patting on their social networks of family, friends, acquaintances, neighbors, colleagues, and associates. Social capital embedded in these networks indicates that the information provided about potential candidates is trusted, which eases managers in their decision-making (Bouzdine and Bourakova-Lorgnier, 2004). In addition, taking part a new social organization is somewhat like an initiation into the existing relations and codes within social network, which part finishes by means of inclusion and a feel of inclusiveness. This helps talented people stick with their jobs because they appreciate meaning of their work and created a sense of community. They feel the sense of belonging and identify with firm, which could greatly benefit firms in many ways. For example, employees with sense of belonging often tend to

give accurate information to the firm (Bintijaafri, 2012; Bouzdine and Bourakova-Lorgnier, 2004). In simple terms, this is the proposition that the quality of relationships amongst people has a major influence on economic performance.

In research, social capital theory has been applied in various fields. For example, according to Roxas and Chadee 2011, inter-firm networks or the networks of among the managers or owners of firms act as channels to funnel externally available resources into the firm. Other researches posit that social capital grants firms with entry to resources such as strategic knowledge that are essential to processes of value creation because they permit firms to deduct the transaction costs of exchange and social interaction (Bonner et al., 2005; Luo, 2003; Ainuddin, Beamish, Hulland, & Rouse, 2007; Bonner, Kim, & Cavusgil, 2005; Ellis, 2010; Ma et al., 2009; Newbert, 2007). In addition, social networks allow the flow of valuable information into the firm, improve its strategic knowledge and facilitate processes that grant a firm to behave innovatively and proactively (Luo, 2003; Walter et al., 2006). This knowledge that passes into the firm may be in the form of know-how (Kogut & Zander, 1992), skills or management capability, business opportunities (Walter et al., 2006) and market knowledge (Kale, Singh, & Perlmutter, 2000).

### **2.3 Resource based view of firm**

The resource based view (RBV) of firms is another theory that has been used to explain why some firms tend to have more superior performance than others. The theory argues that the competitiveness and advantages of an enterprise rests mainly in the adoption of a bundle of valuable intangible or tangible resources at the enterprise's disposal (Oliver 1997). Based on the RBV (Barney 1991), the four criteria's are valuable, rare, inimitable, and non-substitutable. A valuable resource is a resource that enables a firm to manipulate a value-creating strategy, by either outcompeting its rivals and competitors or diminish its own weaknesses. (Mahoney and Pandian, 1992). Rare is to be of value by itself. It is a resource that will not be widely or commonly available. Resources that can only be acquired by one or few companies are considered rare. When more than few companies have the same resource or capability, it results in competitive parity (Barney, 1986; Rothaermel's, 2013). Inimitable, if a firm is able to control a valuable resource by itself it may be a source of a competitive advantage. And if the competitors are not able to imitate this strategic asset completely then this advantage is sustainable (Peteraf, 1993; Barney, 1986). An important underlying factor of inimitability is the firm's competitive advantage stems is from which resource. If the resource in question is of knowledge-based or socially complex as in our study, then firm having these types of resources are plausible to be peculiarity in which it resides (Peteraf, 1993). Non-substitutable, even when a resource is value creating, rare, and inimitable completely, an equally essential aspect is the lack of substitutability (Dierickx and Cool, 1989). If rival firms are able to accomplish the firm's value-creating strategy with a substitute, a gain may result in non-economic profits. (Tsang 1998).

For example, the study of Shou et al (2014) used the RBV to support the role of marketing and technology capabilities as the critical factors that determine the performance of Chinese firms. The study of Jalali et al (2013), focused on Iranian firms, also used the RBV as an underpinning theory to stress the importance of entrepreneurial orientation as a firm's unique proprietary asset that can enhance firm performance. Zhu and Kraemer (2002) use the RBV to examine the interaction effect between a specific dynamic capability (e-commerce capability) and a given resource (information technology infrastructure) on different measures of performance of firms. Carmeli (2001) used the previous studies from

Hall (1992, 1993) as motivation for his own research. Nevertheless, unlike Hall, he used the RBV framework to investigate whether the profile of perceived core intangible resources in high-performance firms was dissimilar from those as shown as evidence in low-performance firms.

#### **2.4 Managerial ties and firms' export performance**

Based on the social capital theory mentioned above, this research proposes that relationship that firms build with various entities can benefit firm performance. Specifically, this research focuses on managerial ties that firms develop with the managers at other firms, including customer firms, supplier firms, as well as competitor firms. Managerial ties are important drivers to facilitate the gaining of the management favors (McCarthy, Puffer, Dunlap & Jaeger 2013). In the absence of formal market supporting institutions, managerial ties or connections with other managers at different firms have been argued to be a dominating area to get the managers' attention in emerging economies (Heath & Peng, 1996). Scholars also argue that the fewer market-supporting institutions are established, the more need managers will feel about devoting extra resources and time to cultivate managerial ties (Yang & Poppo, 2008; Danis et al., 2010; Peng, 2003).

In literatures, managerial ties have been reported to have significant impacts on the performance of firms and enterprises in the emerging economies such as China (Luo & Peng, 2000; Li, Zhou & Poppo, 2008), Hungary (Lyles et al, 2010), Ghana (Acquaah, 2007), South Korea (Kwon, 2011), and Russia (McCarthy & Puffer, 2007). Ties are especially widespread in emerging economies because of the 'institutional voids' (Dacin 1997). Specifically, inefficient and inadequate formal market-supporting institutions in these emerging economies necessitate a strategy centered on developing managerial ties (Prevezer & Estrin, 2011; Heath & Peng, 1996).

Social capital also has tremendous effect on Thai business as well. A research indicates that social capital drawn from social structure is not independent for there are large overlaps are present. A common thread of trust forms opportunities, ability, and motivation. The research highlighted that managers can develop social capital and use social capital as a marketing tool and strategy with the export relationship in Thailand (Theingi, 2007). Further, a study investigates the influences of social capital on three different dimensions: the structural dimension, the cognitive dimension, and relational dimension in relation to organizational innovation and absorptive capacity. The study collected questionnaires from 119 Thai leather product-exporting firms. The results suggest that both cognitive and the relational dimensions have a positive significant effect on absorptive capacity. Subsequently, absorptive capacity has a positive significant effect on organizational innovation (Kittikunchotiwut, 2015). In another research, when creating the business, it is proven that new entrepreneurs can benefit from social capital, and therefore, entrepreneurs are considering networking, one remark of social capital, as an important tool for new business development (Apiratpinyo, Suwannapisit, 2010)

McEvily and Zaheer (1999) demonstrated that active involvement in professional associations that include members that consist of managers working at different firms could help firms gain access to resources and information. In a similar perspective, they suggested that inadequate institutional conditions marked by uncertain policy and inefficient legal and law systems drive firms to seek ties with other managers at different firms in order to achieve goals. Heath and Peng (1996) also argued in a volatile and uncertain environment, networks

stabilize economic activities by having members engage in reciprocal, preferential, and mutually supportive action. Networks provide flexibility of resource allocation in an environment where needed factor mobility is severely constrained.

Empirical studies also found evidence that the more ties managers develop with other social players will be beneficial in terms of firm's performance. For example, a data survey from China found that the managers' micro interpersonal connections with other top executives at different enterprises can help strengthening the macro overall organizational performance (Peng 2000). In another source, a meta-analysis of 61 different samples shows that the positive relation between the social capital and firm performance was significant (Stam 2013).

Moreover, the contribution of managerial tie on performance of firms can be supported by the RBV. In the resource-based view, the firm is viewed as a combination of resources that contain vital intangible resources, which can create greater profits and competitive advantage. It is argued that social capital stands out notably among such intangible resources. It is seen that an explicit incorporation of social capital strengthens the analytical powers in the resource-based view in relative to numerous issues (Nielsen, Chisholm). By considering the RBV, the investigation proposes that superior performance is a component of resources that are valuable, rare, inimitable and effectively combined to develop, improve, and sustain the firm's competitive advantage. This study also argues that small, resource-limited export firms in a developing economy are able to develop entrepreneurial tactics and cultivate positive rates of return. Social capital is value creating that is no substitute in nature. In the present view, firms do not operate in seclusion but rather are rooted in a network of relationships as they make value creation (Ma et al., 2009; Manolova et al., 2009; Walter, Auer, & Ritter, 2006). This network of relationships with individuals, social or economic entities, and other firms create some form of intangible related assets valuable to the firm.

Other researches have extended the scope of resources that a firm may achieve in pursuit of competitive advantage (Barney, 1991; 2007; Chrischold & Nielsen, 2009; Locket, Thompson, & Morgenstern, 2009; Wernerfelt, 1984; Newbert, 2007). Social capital is perceived as an asset that allows the firm entry to various resources that may be beyond its reach as if the firm were acted in seclusion (Lages, Silva, Styles, & Pereira, 2009; Davidsson & Honig, 2003). Moreover, social capital is viewed as a resource that streamlines export activities of firms and covers gaps such as the lack of available information on export opportunities in the institutional environment.

Building on the framework of VRIN, studies argue that social capital grants firms to gain knowledge about exporting which supports managers' decision, allowing firms to create positive returns on its export activities (Barney, 1991; 2007; Chrischold & Nielsen, 2009; Locket, Thompson, & Morgenstern, 2009). Some studies suggest that among the various resource types of VRIN, intangible resources of firms are probable to become strategic assets for strengthening competitive advantage as these resources are likely to be valuable, imperfectly imitable, rare, and difficult for competitors to substitute (Barney, 1991; 2007; Chrischold & Nielsen, 2009). A network model on internationalization of firms (Hadley & Wilson, 2003; Ellis, 2010; Federico, Kantis, Rialp, A., & Rialp, J. 2009) also emphasized that a performance of firms in their export ventures depends mainly upon their ability to create and sustain a strong and reliable network of relationships in both the domestic and international markets.

Social capital is a resource that must be generated over time, a resource which can provide firms with an understanding of the possible opportunities and constraints for its export activities (Hadley & Wilson, 2003). In addition, the 'capability' or 'organization' element of Barney's (2007) in the RBV refers to knowledge and information-based as firms' particular tangible or intangible processes that develop over time through complex interactions among the firm's resources. This view suggests that firms' ability to gain information and innovate is an example of their ability to array resources to develop and enhance firms' outputs over some period of time. This reinforces that social capital is certainly resources in the RBV.

This section attempts to link social capital to the value-creation of firm by the RBV. On the theoretical front, social capital serve as pathway through which the sample firms are able to gain, streamline or augment their export information and knowledge and extend the scope of a firm's strategic asset in the context of RBV (Armstrong & Shimizu, 2007; Barney, 2001b; Newbert, 2007). Under the framework of VRIN in RBV (Barney, 2007), a firm must attain the "organizing capability" to tactically exploit its valuable, rare, and imperfectly inimitable and non-substitute strategic assets. This result illustrates that managerial ties, an aspect of social capital, is an example of this "organizing capability" that exploits and leverage valuable and rare export knowledge and information for firms.

By caring for these resources that possess these important assets may improve organizational performance (Crook et al., 2008) Therefore, granting firms that possess such social capital have a strong advantage and hence, improve their export performance (Tsang 1998).

Considering all supports mentioned above, the first hypothesis is presented as the following:

*Hypothesis 1: Managerial ties will positively associate with export performance.*

## **2.5 Managerial ties and international learning capability**

International business and exporting can be challenging. There are differences in doing business internationally than doing business at home. There are new knowledge to acquire and skills to learn about the country exporting firm is going into. The firm will need to gain knowledge about the different laws and regulations, which conceptualized in the institution distance, the habits of the buying customer, and adapt the marketing strategies and products to appeal to the new country of entering. Also, it is important to remember that the way firms operate their business will be determined by the culture of the home market, not the firms', which can be comprehended by the concept of cultural distance.

International learning capability is one of the major constituents behind how firm would behave internationally in terms of the ways through which firms take part in the markets, the swiftness of the launch, and how they select foreign markets. Thus, the ability to acquire critical knowledge has been clearly connected with the international learning process of firms. International learning capability is observed as a line of increment decisions by mean of which in order to lower the degree of risks and uncertainty, as firms gain experiences and knowledge in a country, they become more willingly to increase investment in the more advance and secure ways of functioning in that market (Brouthers et al., 2009). Lack of



experience, and knowledge are important barriers to improving performances of firms.

Top managers, management teams, and entrepreneurs carry with them to the new firms their previous experiences, abilities, and international knowledge, which are derived from their backgrounds. Nonetheless, this previous experience may later become obsolete or outdated over time, and therefore new learning and knowledge acquisition is required. At the inter-corporation networks level, newer firms may benefit from the advantage of learning knowledge that has already been acquired by the older firms, where corporation structures and routines are being incorporated and put in place. However, in some instances where inactivity may hinder older firms' abilities to achieve learning, newer firms may then share the new knowledge with older firms. (Roger, Cavusgil, and Zhou, 2002).

It has been claimed that international learning capability allows firms to effectively acquire critical knowledge required to successfully compete in foreign market and improve export performance by overcoming institutional distance as well as cultural distance. (Chien & Tsai, 2012). Firstly, international learning capability is an important factor in overcoming the institutional distance. As in the recent decade, the idea of 'institution distance' has become the major belief among the economists and multi-facet organizations. The concept of 'distance' has been the center of attention to international business scholars in attempting to describe variation in operations across boundaries and international business strategies. The further the distant of a host country is to the middle of multinational enterprise, the more firm needs to adapt to and bridge the differences in laws and regulation, culture, and other organizational routines and practices. The multinational enterprise and firm has to learn and bridge its organizational forms, its entry strategies, and international procedures to manipulate the differences (Johansen and Vahlne, 1977; Kogut and Singh, 1988; Kostova and Roth, 2002). Thus, when a firm enters a new foreign market or an international market there is a lack of knowledge such as law and regulations of the new market. Hence, International learning becomes explicitly essential when there is weak institution, to overcome the lack of knowledge embedded with the institution distance.

Secondly international learning capability is also another important factor to facilitate the drive in overcoming the cultural distance barriers, since no two cultures are the exactly the same and understanding both the social and business culture in exporting country is the first key towards success. Culture determines everything a society does, from the practice of business, to its response to marketing and advertising, to sales negotiation. Understanding these essential areas will mostly better prepare firms when first enter into the market. The unknown knowledge about cultural differences can bring difficulties to firms. Previous research has found that firm's ability to overcome cultural barriers and form close business relationships with other partners is a crucial factor of success in the marketing of international business (Ford 1984). Unless exporters are sensitive to the cultural aspect of relationships between the sellers and buyers, it is easier to create long-term quality relationships. Cultural distance concepts suggests that culturally distant exporters must allocate important resources to building relationship activities with the customers in foreign countries in order to heighten mutual understanding and facilitate the reduction of inherent uncertainties in the foreign markets (Doney and Cannon 1997). Hence, heightening the understanding of, and overcoming of, the differences in culture in the international market, which helps exporters decrease the "distance" between both sides in international export relationship. Subsequently, it can be stated that exporters who are sensitive to their associates' culture will encounter fewer barriers to productive communication and tend to achieve long lasting flourishing international business relationships from their increase in

international learning capability (Crosby et al. 1990). A close relationship quality or close tie is more likely to have a positive consequence for both parties in terms of international learning capability (Jap, Manolis, and Weitz 1999). All in all, firms that possess higher international learning capability will have higher tendency to achieve better export performance.

Considering all supports mentioned above, the second hypothesis is presented as the following:

*Hypothesis 2: International learning capability of firms will positively associate with export performance.*

In addition to the direct effect of managerial ties on export performance, this research further argues that the benefit of managerial ties on export performance can be achieved through the international learning capability that firms develop from their network ties. Nowadays, firms rely heavily on the external sources to gain new knowledge that is significant for heightening and improving new product and performance in the markets. Lane et al., (2001) discovered that knowledge gained through an international joint venture from its mother's company led to its improved performance. Yli-Renko et al. (2001) also discovered that knowledge acquisition led significantly to the new product improvement and development. In today's business, one of the most important units of firms is the critical role by which top managers play in the knowledge acquisition. Otherwise, firms would have to carry out some of the fundamental functions such as interpreting regulations, gaining market information, and enforcing contracts on their own (Peng 2000). This can be difficult and time consuming. In parallel, managers need managerial ties to aid them in acquiring new networks and opportunities to improve firm's competitive advantage, because other companies cannot efficiently replicate (Tsang 1998).

Managers in firms often spend considerable amounts of time, money, and all the other resources to maintain and develop external social ties (Powell 1990). Such managerial ties would increase the international learning ability of firms to use, contact, recombine, and acquire new and existing knowledge. Ghoshal and Nahapiet (1998) claimed that social capital helps exploitation and knowledge acquisition by influencing conditions that necessitate the value creation through the combination and interchange of the existing intellectual resources. Because the acquisitions of knowledge are mostly a social process, in social capital views position that managerial ties are valuable, in which ties operate as a channel for knowledge. Therefore, managers are able to interchange the know-how and cultural market demands. Hence, many top managers seek for ways to improve their international learning capabilities by reinforcing firm's social capital among themselves.

In the Chinese context, as they are more closely related to the Thai context, ties are valuable because they allow access to trusted and inside information. Because ties are rooted in a social context of trust and obligation, the information is considered as trustworthy, especially when compared to the information gained from new acquaintances or strangers (Chen & Luo 1997). A firm's external and internal networks, the structure of individual, company, and inter-corporation networks sharing of knowledge, and any external relationships with institutions, suppliers, and customers all have a significant role in enabling firm to increase new knowledge learning capability to expand quickly and perform better in foreign markets. Therefore, it is believed that firms' performance presents a significant impact in the relationship between managerial ties and international learning capability of

firms.

Considering all supports mentioned above, the third hypothesis is presented as the following:

*Hypothesis 3: Managerial ties will positive associate with international learning capability of firms.*

### **3. METHODOLOGY**

#### **3.1 Research context**

The setting of this study is Thailand where an empirical investigation was put in place to explore the subject of export marketing performance amongst domestic Thai firms involved in export. These Thai firms came from a various cross section of industries. The industries that this research represents include consumer products, electronics, home decorations, foods and beverage, garments, raw material products, jewelry, and agriculture products.

Using Thai firms for the study is appropriate for several reasons. As Association of Southeast Asian Nations (ASEAN) region has a solid existence of the international network production (Ando and Kimura 2005), the distinctiveness among Thai firms may result from the effect of spillovers from international network production (Cheewatrakoolpong et al, 2013). Thailand has transformed into an improved economic prosperity and a regional production hub since outward-oriented policies in the 1970s. Electronics and automobiles made up a quarter of exports from this middle to upper income economy in 2010. The regional trade agreement has been emphasized as a vehicle of commercial policy in Thailand. It has pursued the free trade agreements as bilateral since 2001 and takes part in the ASEAN free trade area (AFTA) since 1993. Thailand was selected as one of East Asia's most active free trade agreement (FTA) users in December 2009; having established 11 FTAs and another 6 FTA negotiations was being engaged. Furthermore, according to the account from the Office of National Economic and Social development Board of Thailand, the total volume of export sales of the country are more than two third of the country domestic product. However, Thailand is considered as collectivist country, where social connections, such as managerial ties, are considered as valuable assets that assists firm in various transactions in every area (Puffer et al, 2012). Given the importance of social network in Thailand, using Thai exporters as the sample is appropriate for research that emphasizes on the role of managerial ties on export performance.

#### **3.2 Data collection and sample firms**

This research conducted using 50 self-administered and 74 online questionnaires survey to collect data. The 50 self-administered questionnaires were distributed among the managers of Thai export firms of various industries through self-network connections. For the 74 online questionnaires, one thousand online questionnaires were sent out with the cover letter to export firms of various industries that are listed in the Thai export directory. Out of those one thousand questionnaires, 74 of them were filled out or returned. It should also be acknowledged that the low response rate for this survey was normal for majority of mail surveys (McDougall et al, 1994). The industries were randomly selected with no emphasis on

any one among them in particular. The author realized that it was important to provide the Thai translation of each distributed questionnaires in order to avoid English translation problem. The characteristics of the export firms that were collected in this study are summarized in Table 1.

**Table 1: Characteristics of sampling firms**

Age (years)	Mean = 20.61 (s.d. = 21.55)
Size (number of full-time employee)	Mean = 116.32 (s.d. = 472.54)
Export experience (years)	Mean = 16.48 (s.d. = 23.17)
Export percentage	Mean = 62.10 (s.d. = 48.52)
Methods of exporting	Export directly 79 (64%) Export through intermediary 45 (36%)
Industry	Consumer products: 25 (20.16%) Electronics: 4 (3.23%) Home decorations: 10 (8.06%) Foods and beverage: 25 (20.16%) Garments: 29 (23.39%) Raw material products: 18 (14.52%) Jewelry: 5 (4.03%) Agriculture products: 8 (6.45%)

### 3.3 Measures

An important measurement taken in this research is the measure of firms' export performance. In this study, export performance was assessed in terms of subjective measures. This was due to the difficulty suspected in obtaining actual firm performance when surveying firms in the emerging economies like Thailand. The method had been commonly used in the previous research studies (Calantone et al, 2006; Hashai, 2011). As many emerging economy countries that are in transition can be prone to the reliability problem in export performance, as many of the managers in the emerging economy tend to have strong intensive to intentionally misrepresent their actual firm's financial statement to avoid confrontation with the corrupted government officials and criminal cycles due the attention created, the research considered to assessment it (Peng 2000). Managers within these countries may not be willing to disclose their objective performances that are critical and sensitive information. Therefore, this makes objective measures become difficult to obtain and prone to measurement errors (Rehg et al, 2012). Previous studied had confirmed high correlations between the subjective and objective measures of firm performance (Brouthers et al, 2009; Dess & Robinson, 1984; Dunning, 2000; Wall et al, 2004). This research follows that recommendation of Day and Nedungadi (1994) and Clark and Montgomery (1999), which is the method of using competitors-performance measurement approach that comprises of eight items, which include sale volume, sales growth, profitability, profit growth, return on investment, customer satisfaction, customer retention, and overall performance. The respondent were asked to evaluate export performance by comparing to their main direct competitor areas. The scale ranges from 1: much worse to 7: much better.

The measurement for social capital in this study was examining how manager at each firm have utilized networks and connections with: Manager at customer firms; Managers at distributor (retailer, wholesaler) firms; Managers at competitor firms. The scale developed by Peng and Luo, (2000) was used in this measurement. Respondent were asked to indicate the extent to which they cultivate networks and connections with the three above areas. The scale ranges from 1: very little to 7: very extensively..

The international learning capability was measured by the scale developed by Hsu and Pereira (2008). The respondents were asked the extent to which firms, in the course of international operations, have gained new knowledge and skills. The three factors of the measure were: social learning, which helps firms to penetrate into the foreign markets, the technological learning, which develops new product designs for overseas markets, and the market learning, which is adapting the products for the local markets. The skill was measured by the scale that ranges from 1: limited to 7: extensive

In addition to the above main variables tend to have hypothesized affect to the export performance, there are several other factors that were included as control variables. These controls variables include resources available for international expansion, firm age, firm export experience, firm size, education of the owner, and whether the company perform the majority of export activities. In this study, resources available for international expansion includes the necessary financial resources to pursue foreign markets, the time top management have to really focus on international opportunities and, expertise to assess foreign market potential, and the regular performing of systematic analysis of foreign market opportunities. The author used the scale developed by Hsu and Pereira, (2008). The scale ranges from 1: strongly disagree to 7: strongly agree.

Firm age was the measurement of number of year since the establishment of firms. Firm export experience was the measure of the number of year firm has been in the export business. Firm size was measured by the number of firm's full-time employees. Education of owner was the level of education firm's owner have achieved, which ranges from 1: lower than bachelors' degree, 2: bachelor's degree, 3: masters' degree, and 4: doctorates' degree. Whether the company performs the majority of export activities was whether the company exports by themselves or use intermediary, which was measured as a dummy variable by which choice was coded as 0: export directly and 1: export through intermediary.

### **3.4 Statistical analysis**

The research used partial least square regression (PLS) to analyze the data. PLS combines the path analysis, component analysis, and a set of regression to estimate coefficients of the measurement items in the factor loadings and for the model's path (Chin, 1998). The benefit of this method is it allows the measurement of multiple questions to be simultaneously assessed. Also, the reliability of parameter estimations in a structural model with small sample sizes is higher for PLS when comparing to other methods, which is another major advantage of using the PLS model (Chin, 1998). WarpPLS 5.0 program was utilized as a tool in performing PLS analysis for this research.

## 4. RESULTS

The validity and reliability tests for all reflective latent variables (export performance, international learning capability, and social capital, resources available for international expansion) were conducted before estimating the structural model. The level of convergent validity, the degree to which two measures of constructs that theoretically should be related are in fact related (Trochim, 2006), was first assessed using factor loading. The analysis found that export performance and social capital had factor loading greatly above .5 (Hair et al, 2009).

The construct reliability, the degree to which a measure is correlated with other measures that it is theoretically predicted to correlate with (Campell and Fiske, 1959), of all latent variables was evaluated using composite reliability coefficient and Cronbach's alphas ( $\alpha$ ). The results shows that Cronbach's ( $\alpha$ ) coefficient of all reflective latent variable is above .7 as Nunnally (1978) recommended. Moreover, the reliability indicators of all construct exceed to minimum requirement. Composite reliability coefficient and Cronbach's ( $\alpha$ ) coefficient are reported in Table 2.

**Table 2: Construct reliability of indicators**

	Export performance	Managerial ties	International learning capability	Resources available for international expansion
Composite reliability	0.945	0.931	0.960	0.948
Cronbach's Alpha ( $\alpha$ )	0.933	0.888	0.952	0.918

Next, using the average variance extracted (AVE), the test for discriminant validity, which tests whether concepts or measurements that are supposed to be unrelated are, in fact, unrelated (Campell and Fiske, 1959), was performed. The square root of the AVE of each construct ought to be higher than other correlations that are involved in that construct in order for discriminant validity to be adequate as recommended by Fornell and Larcker (1981). The results were also acceptable. All of latent variables' AVEs and correlation among all variable are reported in Table 3.

**Table 3: Correlations among variables and discriminant validity indicators**

	KNO	EP	NWK	RE	AGE	AGNT	SIZE	EXP	EDU
KNO	(.852)	.671**	.485**	.516**	.212**	.026	.199**	.215**	.141*
EP		(.826)	.486**	.564**	.232**	.04	.115*	.17	.084
NWK			(.904)	.4**	.312**	.112*	.436**	.301**	.274**
RE				(.927)	.3**	-.052	.367**	.293**	.144*
AGE					(1)	.023	.548**	.799**	.093
AGNT						(1)	.022	.009	-.103
SIZE							(1)	.641**	.286**
EXP								(1)	.183*
EDU									(1)

Notes: \*\*, \* significant level at 1 percent and 5 percent respectively;

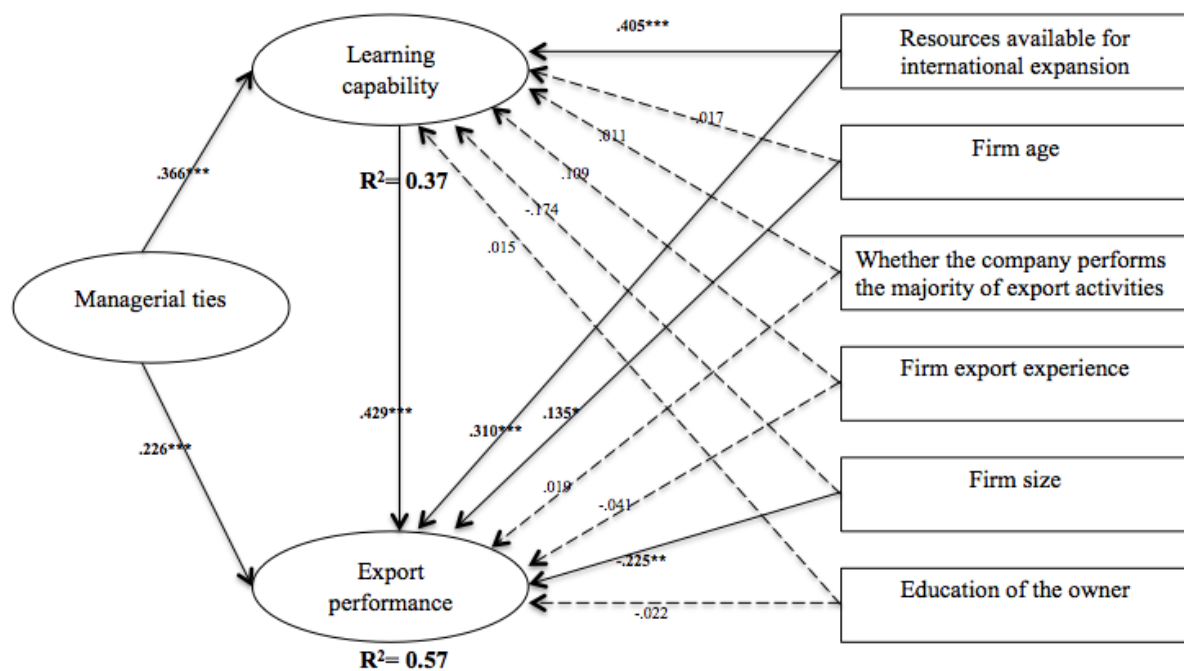
Square root of average variance abstracted are in parentheses;

KNO = international learning capability, EP = export performance, NWK = social capital, RE= resources available for international expansion, AGE = firm age, AGNT= and whether the company perform direct export or export through intermediary, SIZE = firm size, EXP = firm export experience, EDU = education of the owner

Then, the full Variance Inflation Factor (VIF) was performed to test the presence of multicollinearity. The full VIFs in the model ranged from 1.166 to 3.365 which having only one value of 3.365 of export experience of firms which exceed the critical value of 3.30 as suggested by Petter et al (2007). Therefore, this value was removed since it is one of the control variables. The full VIF test also serve as a technique that capsulate the common method bias (CMB) in the PLS model (Whitney & Lindell, 2001) as suggested by Kock and Lynn (2012). They suggested that a serious issue can be raised in the CMB if the full value is greater than 3.3. In this study, all of the full VIF values were significantly lower than the critical value expect for one in the control variable as can be seen by the test result which is acceptable.

The results from PLS analysis is reported in Figure 1. A Bootstrapping resampling technique with 100 subsample was used to estimate the coefficients and p-values (Efron et al, 2004). WarpPLS 5.0 allows us to keep an option that analyze with purely ranked data, by which prior to the structural equation modeling analysis, all of the data is ranked automatically. Typically, the value distances that typified outliers are greatly reduced when that data is ranked which therefore eliminates outliers effectively without any reduction in sample size (Kock, 2012). Therefore, ranked data option was also chosen.

**Figure 1: PLS results**



Notes: \*\*\*, \*\*, \* indicate significant level at 0.1 percent, 1 percent, and 5 percent respectively; Standardized coefficients are reported; Solid lines represent significant results.

Hypothesis 1 predicted a positive relationship between managerial ties and export performance. The result shows that the beta coefficient is positive and statistically significant ( $\beta = .23$ ;  $p < .01$ ). Therefore, hypothesis 1 is supported. Hypothesis 2 predicted a positive relationship between international learning capability of firms and export performance. The result shows that the beta coefficient is positively and statically significant ( $\beta = .43$ ;  $p < .01$ ).

Therefore, hypothesis 2 is strongly supported. Hypothesis 3 predicted a positive relationship between managerial ties and international learning capability of firms. The results show that the beta coefficient is positive and statistically significant ( $\beta = .37$ ;  $p < .01$ ). Therefore, hypothesis 3 is strongly supported.

For the contribution of control variables, the results show that export performance were positively associated with resources available for international expansion ( $\beta = .31$ ;  $p < .01$ ), firm age ( $\beta = .13$ ;  $p = .05$ ), and whether the company perform the majority of export activities ( $\beta = .02$ ;  $p = .35$ ); On the other hand, export performance were negatively associated with firm export experience ( $\beta = -.04$ ;  $p = .35$ ), firm size ( $\beta = -.22$ ;  $p < .01$ ), education of the owner ( $\beta = -.02$ ;  $p = .35$ ). Only the coefficients of resources available for international expansion and firm size are statistically significant.

## 5. DISCUSSION

### 5.1 General discussion

The objective of this research is to investigate the relationship between managerial ties, international learning capability, and export performance. The overall results support all hypotheses. Regarding the contribution of managerial ties on export performance of Thai firms, the study found that Thai firms that cultivate social connection with managers at customers', suppliers' and competitors' firms perform better than those firms that do not. The results suggest that social capital of firms could be an essential factor that helped Thai firms performed effectively in the export market. In addition, regarding the contribution of international learning capability of firms on export performance, the study found that Thai firms with higher international learning capability perform better by their higher export performance than firms with the lower international learning capability. The results suggest that international learning capability of firms could be another essential factor that helped Thai firms performed effectively in the export market.

Regarding the role of managerial ties and international learning capability of firms on the degree to which firms received managerial supports; statistical evidence reveals the strong interconnected among these factors. First, firms with stronger managerial ties reported that they have strong international learning capability. The result which indicates the interdependence between these two factors implies that firms may need to emphasize social capital in order for them to enhance international learning capability of firms. The result also support the managerial ties and indirectly benefit export performance through international learning capability. This mean that the international learning capability that firms develop from cultivating managerial ties can help them achieve better export performance. This finding is consistence with prior research, which suggested that managerial ties are an important facilitator in which firms can overcome the lack of resources in gathering the knowledge and information necessary to leverage international activities and to recognize international opportunities (McDougall et al., 1994; Campbell-Hunt & Chetty, 2004; Coviello, 2006; Dhanaraj & Prashantham, 2010; McDougall et al., 1994; Ojala, 2008; Sullivan Mort & Weerawardena, 2006). Firms can gain access to knowledge and information bases generated by partners and which may substitute for the lack of their experiential knowledge (Saarenketo et al., 2004). In addition, networks offer managers unveil sources for new and timely knowledge and information (Borgatti & Cross, 2003; Luo, 2003), which could be its products or firms' specific. On the present basis that new knowledge and



information is more convenient to use when compares to existing knowledge, firms can exploit a better and more timely understanding about process, operations, and the activities and tasks demanded by suppliers and customers to provide better services and products to them (McAuley, 1993; Lu et al., 2010).

Despite the significant findings above, there are other research limitations that might also be considered. First, the causality is difficult to be concluded because the results were obtained from cross-sectional data. Therefore, the results were only interpreted in terms of the associations among the factors under investigation. Second, the data were collected from a small sample of Thai export firms which may not represent the whole population of Thai export firms. Thus, the generalizability of the results can be limited with the sampling issue. Third, the subjective measure of export performance is susceptible to measurement bias even though it is commonly used in research. Furthermore, although the issue with CMB is not detected in the data analysis, we cannot completely rule out that the problem is non-existence. Fifth, there may be other control variables that could effect the outcome of variables were not included in the analysis.

## **5.2 Research contributions and policy implications**

This research provides extra contribution to literature on the determinants of export performance in emerging economies (Aaby & Slater, 1989; Bilkey 1978; Cavusgil & Kirpalani 1993; Cavusgil & Nevin, 1981; Conconi et al., 2014; Madsen, 1987; Moini, 1995; Reid, 1983; Zou & Stan, 1998). Results from this study gives extra evidence to existing literature by showing that social connections or managerial ties are crucial for international performance of firms in Thailand (Ainuddin et al., 2007; Bonner et al., 2005; Ellis, 2010; Luo, 2003; Ma et al., 2009; Newbert, 2007). This finding is consistent with previous research that found supporting evidence regarding the role of social capital in emerging economies as a main facilitator that provides firms in developing a source of competencies for firms in the export market (Acquaah, 2007; Bonner et al., 2005; Heslam, 2009; Lages et al., 2009; Luo, 2003; Walter et al., 2006). The author of this research provides extra evidence regarding the role of managerial ties as a factor that can explain the ability of firms to acquire resources such as international learning capability and new knowledge, which consequently benefits their export performance (Brouthers et al., 2009; Chien & Tsai, 2012; Johansen & Vahlne, 1977; Kogut & Singh, 1988; Kostova & Roth, 2002; Roger et al., 2002).

Overall, the findings in this study falls in line with the social capital theory and RBV of firms (Barney, 1991, 2007; Chrisholm & Nielsen, 2009; Davidsson & Honig, 2003; Locket et al., 2009; Tzanakis, 2013). The results falls in line with the prediction that when a firm operates in a country with developing market-supporting institutions where market-supporting institutions are not well-developed, it may need to take advantage of social network as a mechanism to facilitate in achieving critical resources from the institutional environment or other business partners (Ellis, 2010; Federico et al., 2009; Hadley & Wilson, 2003). Since managers are one of the dominant resource providers in those countries, firms in emerging economies that lack internal resources to support their businesses must heavily rely on this kind of social capital as a way to help them to overcome their weaknesses by enhancing their international learning capability (Crosby et al., 1990). This evidence indicate that competitiveness of firms in Thailand may not be the complete reflection of their market-based strengths, but it is the ability of firms to cultivate social connections through informal means which also taken an essential part in their performance determination (Roxas & Chadee 2011).

Despite the evidence of the positive effect of social capital or managerial ties and international learning capability of firms unveil in Thailand context (Kittikunchotiwut, 2015; Theingi, 2007; Suwannapisit & Apiratpinyo, 2010), the study does not intend to indicate that these factors are the main sources of competitive edge of firms in the country. Perhaps, the benefits that firms received from these factors may only be short terms and not sustainable. For the long term benefits, as institutional environment in the country with fully developed, those firms that only rely on social capital or managerial ties may begin to depreciates as they do not attain core competencies which are essential for the sustainable competitive advantage (Newman, 2000; Roth & Kostova, 2003).

## **6. CONCLUSION**

In the general context of management favors, overall, the results on the importance of managerial ties and their relationship on export performance can be delineated as widely supportive of the theoretical claims. The study highlights the important role played by social capital in superseding the need and enriching or augmenting the export knowledge of Thai firms in the sample. In the view of social capital, the author argues that managerial ties with managers of customers', suppliers', and competitors' firms are valuable as a conduit for the flow of knowledge and knowledge acquisition from external sources. The inimitability of export knowledge and social capital provides potential strategic assets for the firms. However, firms must develop the international learning capability suggested by the valuable, rare, inimitable, non-substitute properties of RBV, in the form of managerial orientation, to benefit their export by various forms that create value for the firm. Moreover, the author found that ties are a source of international learning capability. With managerial ties, firms could gain new knowledge and ideas from external actors that would allow them to exploit their export knowledge effectively.

In conclusion, a more thorough understanding of the relationship among managerial ties, international learning capability, and export performance will not only assist practitioners enhance their efficiency as they sail through the unpredictable course of economic transitions, but also enriching on the management strategy and favors in terms of literature for the Thai economy.

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## APPENDIX

### DOUBLE DEGREE PROGRAM: CHANCE TO EXPAND YOUR HORIZON RHEINMAIN UNIVERSITY, UNIVERSITY OF APPLIED SCIENCES GERMANY

DOUBLE DEGREE  
YOUR DEGREE



**Prof. Dipl. Des. Claudia Aymar**

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[www.doubleyourdegree.com](http://www.doubleyourdegree.com)

## **DOUBLE DEGREE PROGRAM: CHANCE TO EXPAND YOUR HORIZON RHEINMAIN UNIVERSITY, UNIVERSITY OF APPLIED SCIENCES GERMANY**

- Double degree program
- Cooperation RheinMain University Wiesbaden with International College of NIDA
- DAAD funding for Double Degree Program 2014- 2016
- The objective of the Double Degree Program is to offer students from two countries the chance to achieve two master's degrees within a time frame of two years.
- Companies worldwide are searching for graduates with comprehensive intercultural competence. It is these qualifications which are taught in the new Double Degree Program of the RheinMain University and the ICO NIDA and they can lead to ideal international career perspectives.
- "For me it's a must to study abroad because only by changing your place of study do you get a different perspective which enables you to broaden your academic and personal horizon and helps you to sustainably master life's upcoming challenges."  
(F.P. graduated student of double degree Program)

### **INDEX**

1. Initial situation and objective of a Double Degree Program
2. Participating study programs
3. Structure and curriculum for the Double Degree Program
4. Implementation to date
5. Student Voices
6. DAAD Scholarship
7. Constructive measures
8. Germany Thailand

#### **1. INITIAL SITUATION AND OBJECTIVE OF A DOUBLE DEGREE PROGRAM**

The RheinMain University of Applied Sciences (HSRM) is a university anchored in the Rhine-Main area in the federal state of Hesse and has a goal of strengthening its internationality. Wiesbaden is about 40 km away from Frankfurt and is the state capital of Hesse.

University of Applied Sciences means: Preparation for modern work fields that expect the application of scientific methods or artistic abilities. About 14000 students are taught at the five faculties Architecture and Civil Engineering, Design - Computer Science - Media, Applied Social Sciences, Wiesbaden Business School and Engineering.

Within the internationalization strategy of the RheinMain University, the declared goal is to enter and further develop profile-building cooperations. Since 2011, the International College of NIDA (ICO NIDA) is one of our most important strategic partner universities in Asia. Two master programs of HSRM cooperate with the ICO NIDA.

The cooperation was established on a joint collaboration with Prof. Dr. Piboon, who Prof. Claudia Aymar have known since 2009. Together with Prof. Piboon Prof. Aymar initially developed an exchange program in the undergraduate courses for the Ramkhamhaeng University. This program still exists and because it came by as such a success for our German students, it was clear that we had to follow up with an exchange program for the masters.

The path towards a Double Degree on two socially and culturally different continents such as Asia and Europe is a profound and long-lasting experience for both students and teachers. The RheinMain University sees an innovative and future-oriented chance of building its internationality during the current developments of media policy and the global economy.

Companies worldwide are searching for graduates with comprehensive intercultural competence. It is these qualifications which are taught in the new Double Degree Program of the RheinMain University and the ICO NIDA and they can lead to ideal international career perspectives.

**The objective of the Double Degree Program is to offer students from two countries the chance to achieve two master's degrees within a time frame of two years.**

## **2. PARTICIPATING STUDY PROGRAMS**

The master's program Media & Design Management of the RheinMain University was established in 2009 and has had a high demand and reached its full capacity since the beginning. It is based on the bachelor degree programs Communications Design and Media Management, or any equivalent degree program, and contains content from the fields of media economy, media design and media technology.

The master's program in Media & Design Management aims at preparing its graduates for leadership positions in the media industry and in specialized departments of enterprises that deal with designing and managing the communication to clients and other market participants. For work in specialized departments of large enterprises, students are in particular trained to take on executive tasks, for example in the areas product and brand management or public relations. Thus, the program focuses on topics such as planning, control, realization and mastering market communication tools to achieve creative as well as economic goals.

Special emphasis is placed on interdisciplinary competence by combining contents from business, design and information technology.

Graduates of the master's program look at professional opportunities in the telecommunications, information technology, media, entertainment and security industries as well as in media-related specialized departments of any enterprise in the industrial, trade or service sector. Graduates are prepared to assume executive and leadership roles in all these areas. Through their familiarity with methods and concepts from the above-mentioned areas in connection with the program's interdisciplinary approach, graduates are in particular groomed for filling positions at intersections between enterprises' specialized departments

from the program's subdisciplines media management, communications design and advertising. The program's curriculum is meant to provide students with the management competences and design expertise that will allow them to manage complex projects in their roles as media or design managers, orchestrating the interplay of all project participants across various intersections.

The program contains as well as expands on the curriculum of the former media business and media management and communications design programs. Taking account of current developments in this growing professional area, the program integrated additional areas of specialization as elective concentration modules into its curriculum. The program's graduates are qualified for executive and leadership positions in, for instance, the following professional fields: Film, radio and television, advertising agencies and advertising jobs in other enterprises, communications and creative agencies, telecommunications marketing, media consulting, public relations, media engineering, professional training and continuing education and publishing.<sup>14</sup>

## **SEQUENCE OF STUDIES**

The four-semester program includes both instruction in the general knowledge of the field and options for specialization. Compulsory courses focus on the business, design and information technology fundamentals. The electives promote specializations in particular types of media and functional areas.

Project studies are meant to enable students to implement and further expand their theoretical knowledge, while also allowing them to create important contacts for their later career entry and to apply what they have learned during their studies in professional contexts.

By composing seminar papers, students acquire the academic research skills to methodically examine crucial issues from the core areas of their studies. At the same time, the concentration modules allow students to further solidify their knowledge and keep it up to date. In addition, they instruct students in academic writing skills, thus preparing them for writing their master's thesis.

The master's thesis is to show that the candidate is able to independently to examine an issue from the courses or modules of the Media & Design Management master's program in a manner sufficing academic as well as design standards.

Topics for the master's thesis are based on the electives taken by the student and thus further promote the student's specialization in her or his chosen concentration. All second-semester courses are held in English.<sup>15</sup>

## **AREAS OF STUDY**

Building on the contents of the bachelor's program, the master's degree program in Media & Design Management offers students several concentrations. The possible concentrations are:

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<sup>14</sup> Master of Arts Media & Design Management (2015. October 14). Retrieved from <http://www.hs-rm.de/en/dcsmfaculty/degree-programs/media-design-management-ma/index.html?type=0&F=ojukfmihynuvvam>

<sup>15</sup> Master of Arts Media & Design Management (2015. October 14). Retrieved from <http://www.hs-rm.de/en/dcsmfaculty/degree-programs/media-design-management-ma/program-structure/index.html?type=0&F=ojukfmihynuvvam>

- Marketing & Sales
- Publishing/Content Production (N/A)
- Corporate Communications
- Digital Media Production
- Rich Media Application Design
- Mobile Media & Telecommunications
- Brand Communication
- Concept Development
- Corporate Design

Shaping your study emphases according to your own interests starts in the second semester with deciding which electives to take. In the project studies phase in the third semester and with doing in-depth academic work on the master's thesis, students continue working in their chosen concentrations and enriching them with added professional experience. The following survey will provide you with information about the concentrations content based on the module descriptions of the second-semester electives.<sup>16</sup>

Offered electives are subject to changes and depend on available resources/staff as well as a minimum of five students selecting a corresponding module.

**The Master of Arts consists of four semesters and a total of 120 ECTS/Credit points.**

### **Voices of graduates from the master's program Media & Design Management:**

#### **Graduate WS2012: Svenja G.**

Joint Partner of StartUp [www.svave.de](http://www.svave.de) and responsible for Business Development, BHMAAsia in Bangkok

“It really paid off! The master's program Media & Design Management won me over with its wide range of specifications and large practical relevance. I also really benefited from the exceptional chance to participate in a double degree program with a Thai partner university. In the standard period of study it is possible to achieve a master of arts and master of business administration (MBA). Surely this is associated with a higher demand in effort, but it enriches the studies program with an international business economical aspect and exciting experience from abroad.”

#### **Graduate WS 2011: Marc N.**

Junior Consultant, Accenture, Amsterdam

"Any time again! Most teachers have great contacts in the industry. This makes for exciting projects in cooperation with companies. Guest lecturers were a great enrichment. But also in the university itself, teachers are recognized experts. The supervision in the modules was very good. I chose the modules Brand Communication, Corporate Communication and Rich Media Application Design and I got to work on a project for Arthur D. Little in my 3<sup>rd</sup> semester. Directly after graduating I became a consultant at Accenture in Amsterdam. The studies program was very demanding and really paid off for me!"

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<sup>16</sup> Master of Arts Media & Design Management (2015. October 14). Retrieved from <http://www.hs-rm.de/en/dcsm-faculty/degree-programs/media-design-management-ma/areas-of-study/index.html?type=0&F=ojukfmihynuvvam>



**Graduate WS2011: Thies H.**  
Consultant, Mücke, Sturm & Company

"I would do it all over again! The studies program offers a broad spectrum of specifications, students get the chance to follow individual focal points and a large part of the program consists of (mostly) exciting practical projects. Especially in the projects, a further advantage comes to light: The structure of the studies program from the areas of media economy, media production and media technology, and design are very heterogeneous and open up new perspectives."

**Graduate WS 2011/12: Julia H.**  
Project manager, Scholz & Volkmer GmbH

"At the RheinMain University one often cooperates with companies and obtains good insights in the business life. With a variety of contacts from the industry we got to work on exciting projects that were very useful for business." <sup>17</sup>



*Private Photos of graduation celebration of RheinMain University Master of Media & Design Management at Castle Biebrich in Wiesbaden.*

### **Master of Arts in Management at the ICO NIDA**

**The International College of NIDA engages in the Double Degree Program with the Master of Arts in Management.** The International Business Management concentration is designed to equip students with the leadership and strategic international business skills necessary for thriving in a global economy. The program is suitable for individuals who desire information on policy formulation and implementation that will enable them to facilitate international business and trade practices in a vibrant global business environment.

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<sup>17</sup> Master of Arts Media & Design Management (2015, October 14). Retrieved from <http://www.hs-rm.de/dcsm/studiengaenge/media-design-management-ma/absolventen/index.html>

This program aims at providing knowledge in areas such as:

- International business management
- International trade practices
- International business strategies and operations
- Cultural, social, and political dimensions of global business
- Communication and negotiation in global business<sup>18</sup>

**The master's program at the ICO NIDA achieves a total of 39 credit points.**

### **3. STRUCTURE AND CURRICULUM FOR THE DOUBLE DEGREE PROGRAM**

#### **Study plan and structure for the UAS students:**

The basis of the decision to work in cooperation with the ICO NIDA for the double degree program was the high demand and the students' increasing interest in extending their competences in the area of international management.

The study plan of the Master of Arts Media & Design Management has a similar structure to the earlier mentioned program at the ICO NIDA. The master's programs content overlaps in some parts and in other parts they complement each other and offer students further specifications in areas of expertise. This means that students are able to further specialize in the areas of management or media and design.

**From the perspective of the participating universities, the program offers a win-win situation – in an academic sense.**

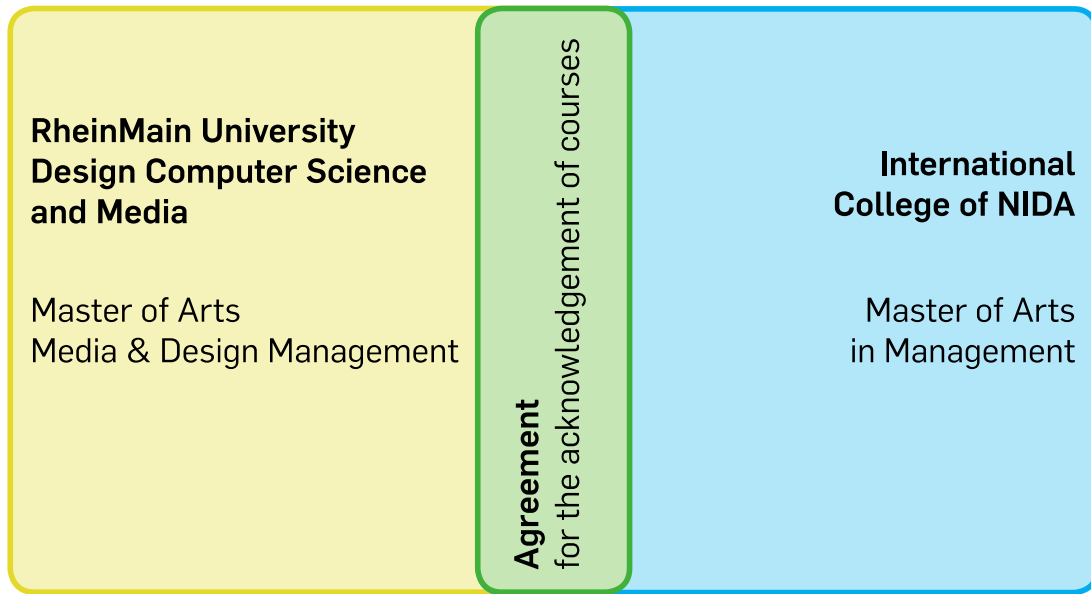


*(Private Photo)*

A useful double degree program should consist of 30-40% of overlapping courses and about 60-70% of extended areas of expertise. A recognition system is then fulfilled and can be expanded to new areas of expertise.

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<sup>18</sup> ICO NIDA (2015, October 10). Retrieved from <http://ico.nida.ac.th/en/international-bus-mgt>



Graphic: Own representation Prof. Aymar

**The time plan, structure and recognition system of the double degree program is a result of this fact.**

The students of the RheinMain University begin the program by studying in Germany for their first two semesters.

**The first semester consists of lectures in:**

- Media companies and markets
- Market and media research
- Management and Personnel
- Business Development
- Technology and Innovations Management
  
- Design
- Image Technologies
  
- Interactions Design
- Digital Communications Design
  
- Design and Media Theory
- Design Industries and Markets<sup>19</sup>

In **the first semester** it is important to bring all students from the different bachelor programs onto one equally professional level. As stated earlier, students can come from the areas Communications Design, Media Management, Media: Conception and Production or similar studies programs.

Shaping your study emphasizes according to your own interests starts **in the second semester** with deciding which electives to take. In the project studies phase in the third semester and with doing in-depth academic work on the master's thesis, students continue

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<sup>19</sup> Curriculum Master of Arts Media & Design Management

working in their chosen concentrations and enriching them with added professional experience. The following survey will provide you with information about the concentrations content based on the module descriptions of the second-semester electives.

Building on the contents of the bachelor's program, the master's degree program in Media & Design Management offers students several concentrations. The possible concentrations are:

- Marketing & Sales
- Corporate Communications
- Digital Media Production
- Rich Media Application Design
- Mobile Media & Telecommunications
- Brand Communication
- Concept Development
- Corporate Design

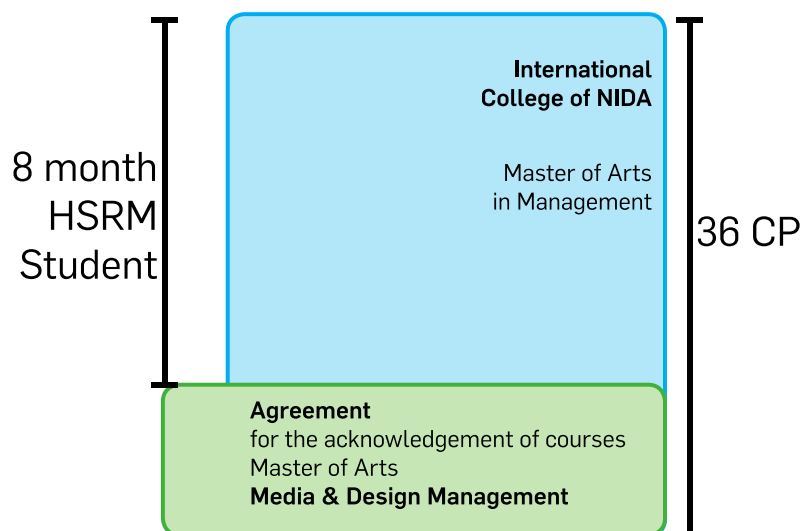
Offered electives are subject to changes and depend on available resources/staff as well as a minimum of five students selecting a corresponding module.<sup>20</sup>

**At the end of the 2nd semester**, the students of the UAS Wiesbaden travel directly to Thailand to begin with their master's in management at the ICO NIDA.

Requirement for participating in the program is achieving at least a B in all courses during the first and second semester. The grades (certified transcripts) are sent to the ICO NIDA by coordinator Prof. Aymar.

**HSRM Students start in Thailand middle of July of each year**

The ICO NIDA starts its one-year master each year in May. This means that the UAS students “miss” 2-3 courses of the program. These courses are acknowledged from the German master's program.



Graphic: Own representation Prof. Aymar

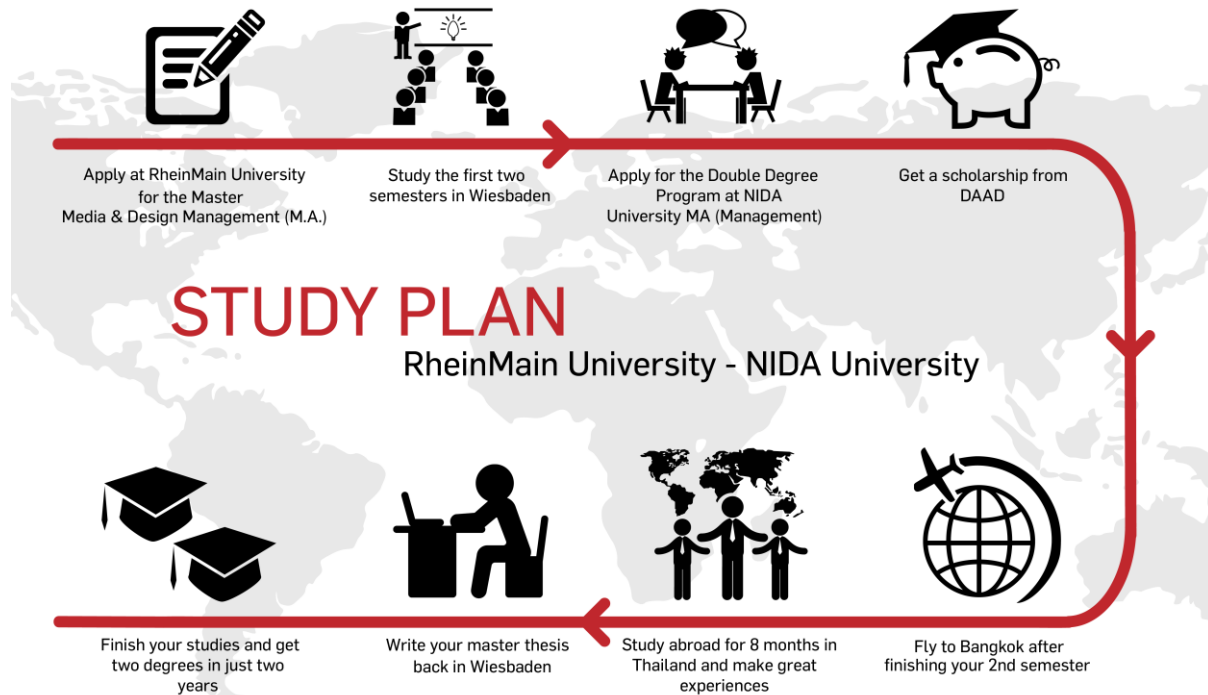
<sup>20</sup> Master of Arts Media & Design Management (2015. October 12). Retrieved from <http://www.hs-rm.de/en/dcsmfaculty/degree-programs/media-design-management-ma/areas-of-study/index.html>



The UAS students take part in courses at the ICO NIDA in the following 8 months of the study program. The UAS students are enrolled as regular students at the ICO NIDA and all test regulations also apply to the UAS students.

The courses/ECTS Credit Points are mutually acknowledged. This makes it possible for the students to graduate with both degrees.

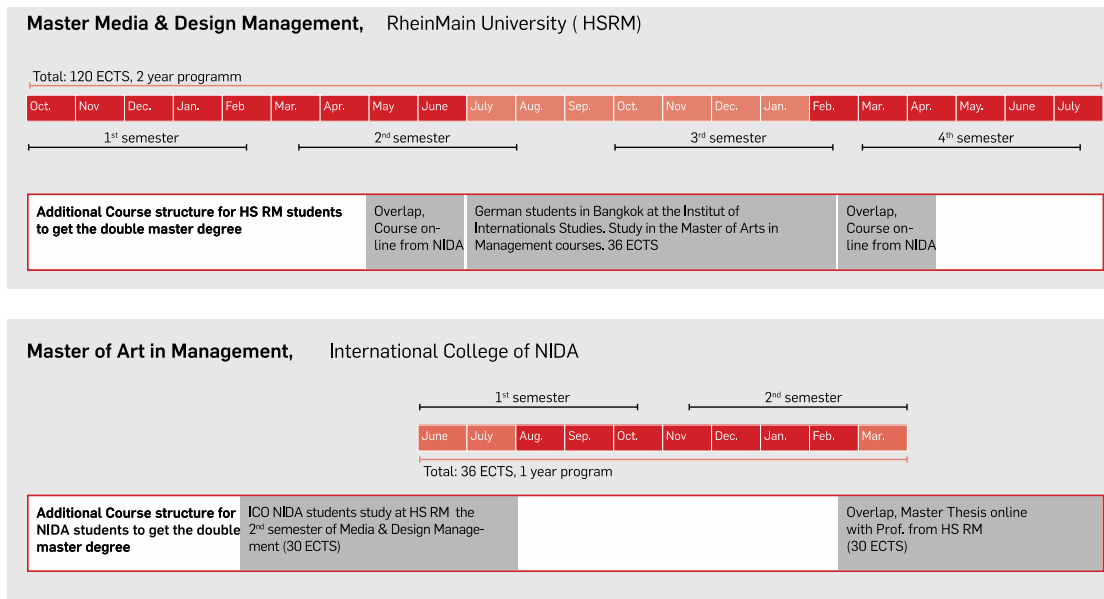
**Study plan for UAS Wiesbaden students:**



Graphic: Student work<sup>21</sup>



<sup>21</sup> Study plan for UAS Wiesbaden students (2015. October 14). Retrieved from <http://doubleyourdegree.de/studyplan-hsrm-nida/>



Graphic: Own representation Prof. Aymar

### Study plan and structure for ICO NIDA students:

The exchange is also possible in the opposite direction, offering the same possibilities for the ICO NIDA students. They come to Germany in their second and fourth semester to study in the master's program Media & Design Management.

The students of the ICO NIDA start their one-year Master of Arts Management in June in Thailand. They finish their studies in June of the following year. For their international MA they achieve a total of 39 credit points which are divided in fundamental courses, core courses, specific courses, independent studies and a final comprehensive exam. During their studies, the students sign up for the double degree program in the principal's office of the ICO NIDA. Upon their grades, letter of motivation and references, the principal selects which students are qualified to participate in the double degree program.

After the application, students are invited by the UAS. This invitation can be used to apply for a one-year visa.

The students get support from the International Office of the RheinMain University on their search for lodging.

In February the NIDA students can participate in German language courses and other activities for incoming students by the International Office.

The UAS also maintains a buddy program to support NIDA students during their stay in Germany.

The **2nd semester** of the Media & Design Management M.A. begins in March. This semester is taught in English. The students are assigned to a certain module combination which widens their studies in the professional area.

The possible concentrations are:

- Marketing & Sales
- Corporate Communications

- Digital Media Production
- Rich Media Application Design
- Mobile Media & Telecommunications
- Brand Communication (German)
- Concept Development (German)
- Corporate Design (German)

Exams take place at the end of the semester in July.

A module exam is required for each of the modules. Exams may be repeated twice.

The first repeat exam takes place right after the regular exam and the next one a year later.

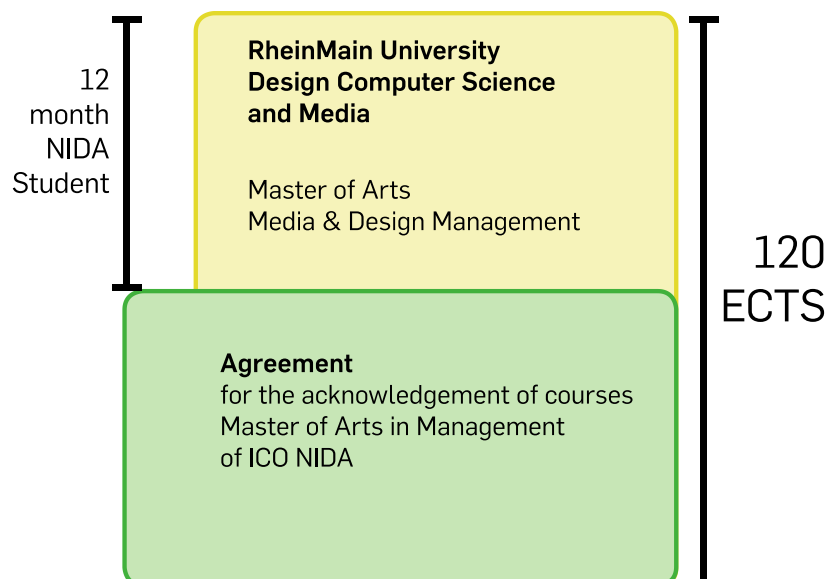
The **4th semester begins in October** and this is when the work phase of the master's thesis begins. The students must prepare an independent dissertation at the end of their master's program. It may be written in English and is supervised by a professor of the university. The collaboration of the professors of the UAS and NIDA can be very supportive, as they have supervised many dissertations together.

The colloquium takes place in February, where the students present their work and discuss it with the supervising professors.

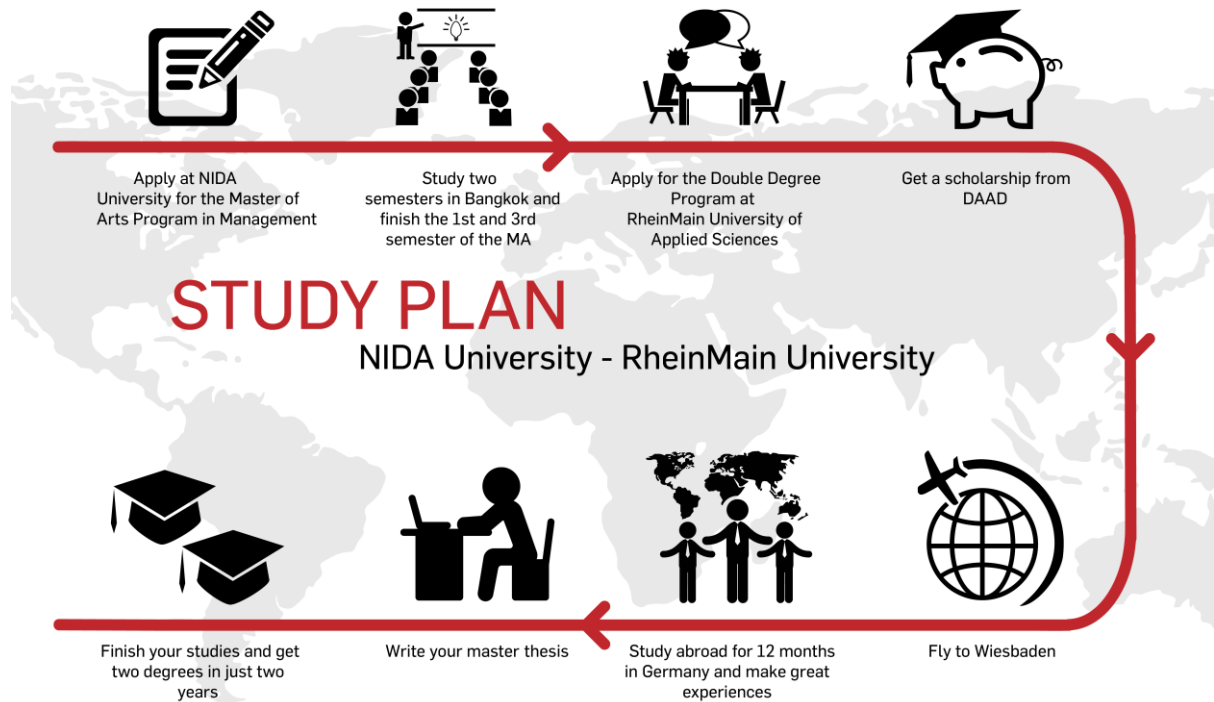
The students of the ICO NIDA MA program therefore finish their second and fourth semester in Media & Design Management in Germany.

For complete recognition of the master's program, all credit points from the master's in Thailand during the first and third semester must be acknowledged. This way the students achieve a total of 120 credit points at the end of their studies in Germany, just like all other master's students. The recognition of credit points takes place as defined in the Learning Agreement.

A module description of the courses at the AUS Wiesbaden can be found under the following link: <http://www.hs-rm.de/en/dcsm-faculty/degree-programs/media-design-management-ma/modules-courses/index.html>



Graphic: Own representation Prof. Aymar



Graphic: Student work<sup>22</sup>



<sup>22</sup> Study plan for ICO NIDA Students (2015. October 14). <http://doubleyourdegree.de/studyplan-bangkok-hsrm/>



## 4. IMPLEMENTATION TO DATE

### Eligibility Criteria for Participation in the Double Degree Program

The students of the UAS Wiesbaden send their applications for the program to the leader of the degree program and the international relations officer. The application must include the following eligibility criteria:

- Letters of recommendation from professors
- Social commitment within the studies program, self-administration, tutoring, etc.
- Qualification in language
- Evaluation of motivation through letter of motivation
- References

After applying, the students register at the ICO NIDA. The ICO NIDA sends an invitation to the students which can be used to apply for a student's visa in Thailand.

The Double Degree Program with the ICO NIDA began in 2011.

2011/ 2012:	2 UAS students attend the ICO NIDA
2012/ 2013:	4 UAS students attend the ICO NIDA
2013/ 2014:	4 ICO NIDA students attend the UAS
2013/ 2014:	4 UAS students attend the ICO NIDA
2015/ 2016:	4 ICO NIDA students attend the UAS
2015/ 2016:	5 UAS students attend the ICO NIDA

The students are enrolled as regular students from each of the universities, so that a transfer of documents can take place at the end of the program. Depending on the situation and the location of the student, the examination regulations of that relevant program apply.

The students can prepare themselves in workshops and individual counseling through the international relations officers of their faculties. Language support takes place in the courses of the study program in Wiesbaden and through additional courses in the national language of the particular university.

### Tuition fees and number of participants

The official grant at the ICO NIDA usually takes place in April of each year.

The RheinMain University celebrates an annual graduation ceremony in June.

The RheinMain University does not demand tuition fees by federal law, so the ICO NIDA students only pay the traditional administrative/university fees (Semester-Ticket, etc.).

There is an agreement with the ICO NIDA that 4 students receive a 100% waiver for the administrative fees and an additional 2 students receive a 50% waiver. In return, the UAS accepts 5 students from the ICO NIDA every year.

**Mutual Guest Professorship:**

Since 2013, various courses have also been held at the ICO International College of NIDA at Master of Arts Program in Management

Guest lectureships of RheinMain University professors:

Prof. Wolfgang Schiffler:

CM 6004 Concepts and trends in communication innovation (MA)

Prof. Dr. Stephan Böhm:

MM6003 Managerial Information Technology (MA)

Prof. Claudia Aymar:

CM 6009 CreativeThinking and Story Telling (MA)

Prof. Dr. Christoph Kochhan Marketing (MA)

**Guest lectureships of ICO NIDA professors:**

In 2014 Dr. Vesarach Aumeboonsuke from the ICO NIDA held a lecture in the field of International Management for the Media & Design Management students.

We are planning on inviting more professors of the ICO NIDA to the RheinMain University.

Since 2009, various mutual projects have been performed, such as information films about the studies programs and universities.

The film projects can be viewed online at: [www.doubleyourdegree.com](http://www.doubleyourdegree.com) .

## 5. STUDENT VOICES

Statement from DM graduate N.J.: “A change of location really broadens one’s horizon. Studying in Germany is just “studying in Germany”. But working with international professors or in groups of various nationalities is a shaping experience and an ideal addition to the German master’s program. Especially in Thailand, one is taught to be patient and deal with problems one is not necessarily confronted with in Germany (...).

The personal benefit is definitely the fact that I want to and know I am capable of working internationally in my future career. Adapting and assimilating to foreign cultures was never a challenge for me and my experience during my 10 months in Bangkok only confirmed my knowledge in this. Understanding and meeting people from different nationalities and working with them, in their different ways of thinking and living, has had a large benefit for my future when working in an international work group.”

Asia and Europe are two continents with completely different cultural and historical backgrounds. The exchange with such a different university is especially an advantage in the aspect of challenging the students to see issues which are conceived as ‘natural’ from a fully new perspective. This broadens the personal horizon and helps young adults to strongly develop in a short amount of time and gain intercultural competences.

In spite of all the differences, the result of the collaboration to date has come to show that the students feel comfortable in their partner countries straightaway. During their stay, the students take part in various trips to media companies/corporations, guest lectures, exhibitions and other cultural activities. These are organized by the relevant international office and the buddy system.

Statement F.H.: "(...) The change of my study location to Bangkok gave me a deeper insight on the Southeast Asian culture, which I really learned to value and appreciate. The change of perspectives lead to a strong self-reflexion and reflection of the roles of others, which then lead to a higher sensibility and tolerance for foreign cultures. In teams we conducted informational events for the students in Bangkok who were interested in the double degree program. This did not just result in a strong cultural exchange, but also inspired long-term friendships between the Thai and German students."

Statement F.P.: "(...) I personally see a stay abroad during the studies program as an absolute "must", because initially, it is the change of location that triggers a change of perspective which significantly broadens the academic and personal horizon and allows oneself to grow through the challenges overcome during life abroad."

"(...) My response is that a double degree program abroad has a significant added value in comparison to a "regular" master's program. It is a once in a lifetime chance to develop further personal and professional skills and prove oneself in an unfamiliar environment. Of course it isn't really a "must", but in my opinion, it is very important nowadays to broaden one's horizon through a study abroad."

(...) "The significant benefit of the double degree program, in my opinion, is the personal development and the additional qualification which could play a major role in future application procedures. A stay abroad is surely also promotional for a career because it proves a certain degree of cosmopolitanism, flexibility and interest in new topics and challenges.

Through the DAAD scholarship I came into contact with other fellow scholars in the country. An exchange with some of these contacts still existed even after the return home. I am also still in touch with other students in Thailand. In any case, the study abroad in Bangkok helped me meet many interesting and different people. I benefited from my stay abroad in every possible aspect: academically, professionally and personally. Furthermore, the financial support from the DAAD allowed me to fully concentrate on my goals during my study abroad."

(...) "The double degree program has always been a topic of interest during job interviews by far. I am convinced that the combination of both master's degrees is capable of opening many doors for promising entry level positions in internationally-active companies. The professional combination of knowledge in media and business seems to be in demand in large media groups."

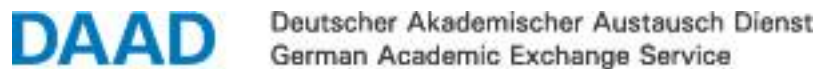
## 6. DAAD SCHOLARSHIP

### **The double degree program receives funding from the DAAD.**

Deutschen Akademischen Austausch Dienst, German Academic Exchange

With this support, all nine UAS students in the years 2013/ 2014 and 2014/ 2015 were able to be funded with an eight-month scholarship of 800 Euro per month, plus travel costs and insurance. The funding for each student adds up to 6.680 Euro per student. Additionally, in the years 2013/ 2014 and 2014/ 2015, all nine students of the ICO NIDA were funded with a twelve-month scholarship of 400 Euro per student, per month.

The application for funding has been submitted by Prof. Aymar and the International Office of the RheinMain University for the second time already and both applications were accepted. The funding in the time frame from 2014 - 2016 amounts to about 150.000 Euro. (The funding includes the double degree program of the NIDA and the Ramkhamhaeng University)



## 7. CONSTRUCTIVE MEASURES

Through the cooperation with both master's programs, the idea of developing **a mutual PhD program emerged**. Then in 2014, a contract was signed. We currently have 3 candidates who are completing the mutual PhD program and being supervised by professors from both partner universities.

This agreement administers the exchange of junior scientists between the universities within a PhD-cooperation. Thereby master's graduates or research associates of the RheinMain University are offered a chance to work on their dissertation at the ICO NIDA within the cooperation. This also highly contributes to the image of the RheinMain University as a center for research. The agreement also explicitly improves international networking and the visibility of the RheinMain University.



Signing of the PhD-cooperation between the RheinMain University of Applied Sciences and the renowned Thai university ICO NIDA in Bangkok <sup>23</sup>

<sup>23</sup> RheinMain University of Applied Sciences and the renowned Thai university ICO NIDA in Bangkok (2015, October 10,) <http://caebus.de/phd-kooperation-ico-nida-hsrm/>

A further MOU and agreement for a double degree program was made with the Wiesbaden Business School's master's program International Business Administration.

Further information: <https://www.hs-rm.de/en/wiesbaden-business-school/international/outgoing-students/double-master-degree-programs/index.html>

## **8. CONCLUSION**

### **: A DOUBLE DEGREE PROGRAM BETWEEN UNIVERSITIES FROM GERMANY AND THAILAND**

A transnational double degree program is a worldwide study program with a positive outlook. There are many advantages for students participating in such a program:

- Recognition of academic achievements
- Two degrees within a determined time frame
- Seamless integration of the stay abroad into the studies program at home
- Specialization and added value through additional lectures in specific areas
- Integration into an international academic, cultural and social system
- Further development of language and intercultural skills
- Qualification for an international career

To the universities and the professors, this model represents the 'excellency in teaching' in an international context. For the RheinMain University and myself, as operating German coordinator and professor of the program, being in an international lecture room is a lasting and positive experience.

Thanks to the great professionalism and collegiality of our colleagues at the ICO NIDA, it is a pleasure to continue striving toward a shared future. Nationality plays no role here – the sole purpose is to expand the horizon of students and our learning institutions.

"The double degree program offers a significant added value to your "simple" master's program. It's a unique opportunity to study further on both your professional as well as your personal growth and to prove yourself in unfamiliar surroundings. In my opinion, nowadays it is very important to broaden your horizon by studying abroad." - Nicolas Jorczik

"For me it's a must to study abroad because only by changing your place of study do you get a different perspective which enables you to broaden your academic and personal horizon and helps you to sustainably master life's upcoming challenges." - Felix Pohl

"During my previous job interviews for permanent employments, the double degree program has always aroused the interest of my dialogue partners. I am convinced that the combination of both master degrees function as a door opener for promising entry-level positions in international operating companies. The combination of media knowledge and business knowledge is especially great in demand from media groups." - Felix Hustedt



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