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PROBLEMS OF MAINTAINING ADEQUATE ACCOUNTING RECORDS FOR A NON-PROFIT ORGANIZATION IN SUB-SAHARAN AFRICA

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ABSTRACT

This paper looks at the accounting challenges faced by a small-scale non-profit organization operating in sub-Saharan Africa. We will look at the case of Enright Flight Ministries, Inc. a 501(c)3 non-profit organization based in Florida that carries out evangelical and humanitarian aid projects in Zambia. Building upon field interviews with administrative staff and project managers, we analyze the various problems facing the organization in maintaining adequate accounting records. After looking at both external and internal problems, we investigate the solutions employed by Enright Flight Ministries to maintain the integrity of accounting systems to derive best practices for the small-scale international non-profit organization.

JEL: M41, M42

KEYWORDS: Accounting Records, Non-profit, Statements

INTRODUCTION

Issue proliferation in the development sphere has given rise to thousands of non-governmental organizations (NGOs) aimed at improving lives in the world's poorest regions. No matter if an NGO seeks to address gender equality or environmental degradation, each requires a stringent and sound accounting system if the organization is going to be seen as legitimate and transparent. Designing such an organizational accounting system that stands up to the challenges of working in sub-Saharan Africa is difficult and costly for any entity, especially a small-scale non-profit organization.

This analysis seeks to identify some of the challenges of maintaining adequate accounting records in sub-Saharan Africa as well as to propose solutions for overcoming these difficulties. This analysis will focus upon the case of Enright Flight Ministries, Inc. (EFM), a 501(c)3 non-profit corporation which aims to promote Christian evangelism and economic development in Central Africa. Through the study of EFM activities, we intend to derive a set of best practices to assist small-scale aid organizations operating in similar environments.

Founded in 1992, EFM was designed to be a vehicle through which retired missionaries could continue their work in both Zambia and the Democratic Republic of the Congo with the support of private individuals across the United States. EFM operates out of Daytona Beach, Florida where two non-paid administrators reside. The third administrator is based in Zambia. The Chief Operating Officer (COO) is also stationed in Zambia to oversee all daily operations and the 7 additional EFM employees engaged in project support and development. In addition to these individuals, the various field projects employ approximately 150 local Zambians at any given time.

The business investments undertaken by EFM are designed to provide goods, services, and training to local populations. Revenues generated from the project portfolio are used to supplement private donations in the support of continued business investment, church building activities, and an intensive annual training program for pastors. The major project activities are focused on 6 distinct areas: woodworking

factory, aloe vera production, banana production, organic honey apiaries, tilapia fisheries, and poultry/beef production.

This analysis contributes to the existing body of literature by identifying the specific external and internal challenges faced by a non-profit organization in the implementation of an adequate and transparent accounting system. Where other studies have identified the challenges to accounting systems at a national or regional level, we have found few references to specific cases in the literature. Our analysis also extends the literature by addressing potential solutions to accounting problems that can be implemented at the managerial level to allow organizations to more effectively carry out adequate accounting practices in difficult environments.

We begin our analysis by looking at the relevant body of financial research which addresses the maintenance of adequate accounting records in developing countries. This is followed by a discussion of the value which accounting records provide to EFM. We then draw on field interviews with the administrators of EFM and project managers to identify external and internal challenges to good accounting practices and the solutions which have been tested by EFM. Finally our conclusions seek to extend the solutions employed by EFM to other NGOs that may be operating in similar circumstances.

LITERATURE REVIEW

Research focusing on the challenges of maintaining adequate accounting records in sub-Saharan Africa, and developing countries in general, constitutes a relatively new area of work in the field of international finance. Because businesses in developing countries have historically represented such a small part of the global economy, the study and application of management accounting principles in these regions have been “marginalized” in favor of case studies from developed countries (Alawattage, 2007). This body of literature widely focuses on three main issues: the need for continued development of accountancy in Africa, the challenges to implementing a Western accounting regime, and the contributions of good accountancy to greater development goals.

Organizations operating in sub-Saharan Africa are at a significant disadvantage for maintaining adequate accounting records due to a thin market of accountancy skills and talent throughout the region. Koth (1992) draws on survey reports from the UN Center on Transnational Corporations to describe “a scarcity of fully qualified accountants” and “inadequate accountancy training.” Of 37 countries surveyed in the region, only 3 had more than 1000 qualified accountants (Koth, 1992). Koth finds that there needs to be greater general attention to the training of accountants within sub-Saharan Africa and less reliance on external talent if the field is to grow. Not only does this lack of accounting talent show the need for continued growth, but it also presents a challenge to Western auditing practices which can require many individuals with accountancy skills at different levels of this business. Johnson (1992) also cites low development in accountancy for fostering “informal ways of getting things done” that are currently much more important to organizations in Africa than ensuring adherence to proper documentation and standards.

Of particular emphasis is the identification of cultural and anthropological barriers which can prevent the implementation of adequate accounting procedures. Johnson (1992) draws upon her experiences with the Bank of Sierra Leon to discuss auditing as an “alien phenomenon” throughout much of Africa. Many African cultures discourage “probing” questions and demand that elders, and their business affairs, are respected by all (Johnson, 1992). This presents a unique problem for auditors who, by their very job description, are charged with asking questions to certify accurate accounting records. Societies in sub-Saharan Africa, especially true for Zambia and the operations of Enright Flight Ministries are organized around tribal and familial structures. Johnson recognizes that these close relationships can compromise the objectivity of an auditor or accountant and make it difficult to enforce adequate accounting standards.

Improved accounting practices are directly related to wider development goals. Chung (2012) concludes that basic education in accounting principles and standards are beneficial at the rural level because it would impart skills such as budgeting to local populations that could result in improved savings for future agricultural investment, greater use of financial services, etc. Additionally, Chung (2012) suggests benefits for local participation in civil society because individuals are more apt to participate in political, social, and religious discussions of financial management if there is a common set of accounting principles and standards that can be understood by the general public.

Taking cues from the relevant literature, this study contributes to our understanding by analyzing the challenges faced by EFM to maintain adequate accounting records in daily operations. Furthermore, this analysis recommends solutions to these challenges and best practices that can contribute to the development of strong and reliable accounting standards across sub-Saharan Africa.

THE NEED FOR GOOD ACCOUNTING RECORDS

Maintaining adequate accounting records is an imperative for any business organization that aims to be profitable, accountable, transparent, and legitimate. For most project managers, having solid and dependable information is the key to profitability. Good accounting practices ensure that the managers are provided with current records about the state of operations so that the correct business decisions can be made. Because of the diverse portfolio of Enright Flight Ministries (EFM) investments, each business venture is responsible for maintaining complete accounting records under the supervision of a project manager. On a recurring basis, EFM conducts internal audits of the records to ensure that good accounting practices are in effect and are reported to the corporation administrators.

EFM also has a moral responsibility to the private donors who support the organization to ensure that accounting procedures throughout the organization are strong and accurate. Recent years have seen increased media attention to non-profit organizations that maintain obscene overhead costs or cannot account for funds received. As donors become savvier, non-profits have begun to provide more information to donors in an effort to increase levels of accountability and transparency. To this end, EFM ensures that complete information regarding any donation can be provided to an individual upon request.

Finally, the strongest reason to devote scarce resources to the preparation of sound financial statements derives from the legal and regulatory obligations of the corporation to government. In the case of EFM, the fact that the organization is incorporated in Florida and is funded through private individuals across the U.S. necessitates that EFM file an annual US Tax Return with the Internal Revenue Service. Because EFM conducts business activities internationally, there are also regulatory requirements that must be met in Zambia. The Zambian institution charged with collecting taxes and auditing the financial statements of individuals and corporations is the Zambian Revenue Authority (ZRA). The basic requirements imposed by the ZRA are as follows. A corporation is subject to a turnover tax that is divided into two levels. For a "small" corporation with less than \$40,000 in turnover the tax rate is 3% of net revenue. For a "large" corporation with more than \$40,000 in turnover the tax rate is 15% in the agricultural sector and 35% for everything else. The only caveat is that large corporations are permitted to deduct VAT (value added tax) where small corporations are not.

Reporting requirements also differ on the size of the corporation. For a small corporation you are required to prepare monthly financial statements to be filed with an accountant. The main purpose of this law is to ensure that businesses are paying into pension programs for employees. Large corporations are required to file quarterly financial statements and tax payments based upon annual projections. The ZRA requires that each corporation be audited annually by an external accountant who serves as the liaison between the business and the ZRA. All financial records (receipt books, payroll records, etc.) are required to be stored

at an external accountant's office. Only after the ZRA conducts an audit with the business accountant is the ZRA legally allowed to proceed to the business site to conduct a field audit.

PROBLEMS

As with any international non-profit organization, Enright Flight Ministries (EFM) has faced a significant number of challenges in maintaining adequate accounting systems that meet the needs of project managers, donors, and governments. We choose to look at these problems in two groups: external and internal challenges.

External Challenges

One of the biggest challenges to EFM has been in understanding the often incomprehensible regulatory requirements imposed by the ZRA. As a former British colony, the ZRA has inherited a legacy of bureaucracy that makes it difficult to navigate the filing of annual paperwork without incurring major fines. Even with the services of external accountants there is a serious problem of information transfer between the ZRA and the businesses and accountants who follow their guidelines. In one such instance the accountants who conducted the audit felt that there was no need to file a quarterly report since there was no profit on which to pay taxes. During the ZRA audit the accountant's mistake resulted in a hefty fine, further emphasizing the steep learning curve.

EFM must also cope with the monetary uncertainty of conducting business in sub-Saharan Africa. Zambia operates primarily as a cash-based economy, especially in the small scale agricultural sales of EFM business activities. The largest bill presently in circulation is a 50,000 kwacha note which is valued at roughly \$10 USD. Such small denominations mean that EFM is forced to account for massive amounts of cash that leave a large amount of room for accounting errors. Recent reports in Zambian periodicals also suggest that a major revaluation of the currency will occur in mid 2012 to cut 3 zeroes from each bill. This means that the 50,000 kwacha note will become a 50 kwacha note, and in the process make it very difficult to maintain accurate accounting during the change.

Historical underdevelopment also contributes to the difficulty in maintaining strong accounting practices because high volumes of business are a relatively new phenomenon. In the past two decades, huge investment in Zambia's mining sector from Asian and European markets have helped to spur a national growth rate in excess of 6%. Rising incomes and an emerging middle class have boosted sales across all sectors of the economy, and both businesses and their accountants are dealing with significantly larger operations than in the past. EFM has found that historically smaller businesses have made it difficult to find qualified accounting talent to handle larger volume corporations. As noted before, mistakes on the part of the accountant can result in fines and penalties that are imposed with the ZRA. This combination has resulted in significant search costs for EFM in securing a permanent accountant.

Zambia's historically "thin" markets for goods and services have produced an underdeveloped banking sector that is struggling to cope with new volumes of financial transactions. In the past year, several of the EFM businesses were required to open new corporate accounts at local financial institutions to facilitate new grants and expanded business activities. From these new accounts, fastest time to completion was 6 weeks and the slowest was over 5 months due to a labyrinthine bureaucracy. There is also a significant challenge to EFM accounting records in the transfer of funds from U.S. banking institutions to Zambia. Fees are imposed in the U.S. when funds are sent and in Zambia when funds are collected, representing a significant cost in the management of multiple separate accounts.

Internal Challenges

EFM faces the constant obstacle of balancing the goals of a humanitarian organization with those of a business venture. Managers must constantly evaluate their business decisions to ensure that ventures are economically viable, but that they are also contributing to the overall well-being of the community. These forces are best demonstrated in the wood-shop venture. Manufacturing high-end custom doors, tables, and chairs for sale to private individuals and businesses in northern Zambia is the main goal of the venture and brings in a healthy profit for the business. What happens when another aid activity, say a women's sewing class, needs a table to work on? Should the manager provide a quote that includes a normal markup or should the product be produced for the mission at cost? Under which business is this transaction accounted for? These situations are common in the daily activities of EFM ventures.

Accounting is also made more difficult for EFM due to the limitations of human capital. Because of EFM operations in rural Zambia, agricultural laborers often have very little formal schooling or training in math which can result in significant difficulties in regards to selling, pricing, and inventories. One recent example is in the averaging of weights for the chicken business. The selling price is based on the average weight of a random sample of 10 chickens that are taken from each batch of 500. Every day this sampling procedure is repeated and results are reported to managers. In February 2012, the average weight reported was consistently greater than the weight of any individual chicken. When investigated, it was revealed that the workers conducting the sampling were not aware of how to conduct an average, even after two years of agricultural college.

Besides worker skills, employee character has been a constant problem for EFM operations in Zambia. Managers must be vigilant in maintaining accounting checks in inventory and sales because theft has been a huge problem. In the banana venture this year, there was widespread incidence of theft among the employees charged with sorting the bananas into quality grades of "A", "B", "C", and "no grade". What the graders were doing was assigning high-quality "A" grade bananas into "no grade" crates. Because the low-quality "no grade" bananas are unfit for sale, managers often give them to the employees at the end of the day. In this manner, the employees were smuggling high-quality bananas home which they were then able to sell for a profit in local produce markets. Other instances of theft have included employees forging receipts, stealing inventory outright, lying about cash advances, and the shorting of change to customers. It requires a significant amount of time and resources for the organization to monitor financial records to both find and correct for these discrepancies. Employee compensation also presents a challenge for EFM for several reasons. First, Zambian law through the ZRA only allows for the payment of employees on a monthly basis. This requires maintaining huge amounts of cash on hand at the end of each month, and can often delay project activities due to a cash shortage. Second, the businesses struggle with meeting employee needs. This goes back to the idea of balancing for-profit business strategies with the realities of working for a non-profit humanitarian mission. Situations arise among the employees of each business (emergencies, illness, school fees, etc.) where a cash advance is needed. Unfortunately, in sub-Saharan Africa these issues arise on an almost weekly basis creating a nightmare of accounting records because most employee pay is generally already advanced before the end of the month. Finally, because EFM deals almost exclusively in agricultural products, many workers ask to receive a portion of their pay in the product produced. This practice also produces additional paperwork that convolutes the accounting records.

EFM has also had difficulty maintaining field managers over a longer period. This has created significant continuity issues with internal accounting procedures whenever there is the departure by a major staff member. Because each venture is compartmentalized in operations, there has been no back-up solution or succession plan in place for lower level managers. The case in point for EFM has been the wood-shop which has gone through a series of 4 managers in under 10 years. Each shift has left the finances in disarray and caused EFM to bear greater costs when preparing the venture for a replacement manager.

SOLUTIONS

For Enright Flight Ministries (EFM), there are no simple solutions to the external challenges to maintaining adequate accounting records in sub-Saharan Africa but there are some significant steps that can be taken to mitigate external risk and correct the internal problems. One major step is to use the services of two independent accountants in Zambia. An internal accountant who conducts audits and prepares reports for project managers has now been hired by EFM. This internal accountant is the first barrier against the often incomprehensible laws and accounting mistakes that can result in significant fines. When the internal accountant runs up against an issue that is not fully understood, it provides EFM with advance warning to determine the appropriate actions and paperwork needed to rectify a problem before it reaches the ZRA. This is where the services of the second accountant come into play. The second accountant for EFM works in an external office, and the project managers use reports from the internal audits in their meetings here. The external accountant serves as an important second opinion and is the liaison between EFM and the ZRA. Having two separate accountants, the internal and external accountant, helps to minimize the risk of misunderstandings and fines and is necessary to create a central record and institutional memory of good accounting practices that can be maintained even with the departure of key EFM staff members or even an accountant. Having these two individuals working for EFM will also help to develop the accounting skills necessary to handle the ever increasing quantities of business transactions.

Until Zambia improves the state of banking and finance, large amounts of cash and the fees associated with cash transfers from the U.S. will remain an operating reality for EFM activities. This is why a significant second step for EFM has been maintaining the services of an accounting firm in the U.S. as a means to adequately account for all funds received from U.S. donors and to prepare the annual U.S. Tax Return for EFM. Having a U.S. based accountant is imperative to provide financial information to interested donors and to facilitate the cash transfers to Zambia in the lowest cost manner. EFM attempts to send money in the fewest number of transactions possible to minimize the fees incurred at the bank and maximize the funds available for project implementation. At the same time, holding most of EFM resources in U.S. dollars is a sound strategy that allows the non-profit administrators to mitigate some of the risks and uncertainty associated with the Zambian kwacha. EFM has moved the responsibility for cash accounting onto the managers of each separate venture. At the close of each business day, each manager must reconcile inventory, sales, and cash receipts for review by the internal accountant the next morning. When a discrepancy arises, the internal accountant notifies the relevant manager, who now has the ability to investigate the problem on the next business day. In addition to managing the large amounts of currency on hand, this process helps to safeguard against the problem of employee theft.

In regards to employee skills, EFM has instituted numerous training programs to help boost the language and business abilities of employees to prevent accounting or business errors that arise from miscommunication and human error. One of the most popular efforts has been the formation of English classes for beginners and advanced speakers. These classes are open to employees of all EFM ventures and occur twice each week. Additional training classes are conducted weekly by managers of the individual ventures. Every employee of that venture is required to attend, and they spend time teaching each worker how every aspect of the business operates. These sessions are useful for teaching the skills required for each employee position (mathematical, technical, accounting, etc.) and serve as an important mechanism for building a relationship of trust and accountability between the managers and the employees. EFM feels that training sessions are the best vehicle to combat failings in the character of the employees and lower the incidence of theft. If the organization is transparent and makes an effort to supply full information to the employees they will be less likely to try to steal because they feel like an integral part of the business activities. Fostering ideas of community ownership, teamwork, and

camaraderie are central to this effort and supplemented by external activities such as employee dinners, picnics, and celebrations.

EFM has also come up with a novel means to address the accounting issue of the single pay period per month. For several of the businesses, every employee now receives a portion of their pay, about 30%, in the form of a cash advance during the second week of each month. This allows the ventures to meet the needs of employee requests for advances while also reducing the amount of cash that must be on hand for payroll at the end of the month. This practice falls entirely in line with Zambian law for employee compensation and has been a large success among workers. It has also streamlined the accounting process because there is not an individual cash advance for each employee, but a standard amount across the board. Also streamlining the process of paying employees in agricultural products has been a new EFM policy where employees are allowed to receive a fixed amount of their salary in the form of finished product. This practice only extends to employees of the relevant venture. For example, a worker in the chicken business can receive part of a salary in the form of 3 chickens but cannot receive part of the salary in the form of fish. This has cut down on confusion (and discord) that arises between the separate ventures, and has gone a long way to improving the clarity of EFM accounting records.

CONCLUSION

Maintaining adequate accounting records requires the significant investment of time and resources for any organization. For Enright Flight Ministries, Inc. (EFM) this responsibility is especially important in an effort to be transparent for private donors, meet the legal obligations of the various countries where operations take place, and to ensure that program funds are used to meet the humanitarian goals of the organization. EFM faces a myriad of challenges to maintaining strong accounting records. Cash based economies, currency uncertainty, and historical under-development, are the biggest external problems. Internal problems include balancing business goals with humanitarian goals, limited employee abilities, and payroll management. EFM manages external challenges through the use of a two accountant system in Zambia and the services of a U.S. based accountant to mitigate the risks associated with international operations and foreign currencies. Internally, the compartmentalization of business ventures under the leadership of project managers has led to a more horizontal business structure that allows for greater monitoring and accountability within the business. Additionally, significant investment in employee training and knowledge sharing are used to combat the prevalence of poor character and low education among workers.

From this case we believe the most significant lessons for small-scale NGO's can be derived from the implementation of a system of checks and balances that include accountants in each country of operations. Too often, the managers of non-profit NGO's are so involved in the implementation of projects or other humanitarian efforts that they are not equipped with the time or knowledge to fully understand the nuances of accounting law applicable in the region. Having accountants in both the U.S. and Zambia allow EFM to satisfy responsibilities to donors and governments in a professional and timely manner, with minimal waste of scarce aid dollars. This system extends into the system of checks permitted by the close interactions of project managers with an internal accountant who works in the field. This system has provided EFM managers with extremely reliable financial reports that have been invaluable in the preparation of annual budgets and sales projections to solicit new donors. Additionally, it prevents accounting errors in one business venture from permeating through the entire organization because the internal accountant has the opportunity to correct bad practices at an early stage. The key to maintaining adequate accounting records in sub-Saharan Africa is to design an accounting system that is able to efficiently adapt to the harsh realities of operating in the developing world.

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BIOGRAPHY

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THE EMPLOYEE STOCK OWNERSHIP PROGRAM PHENOMENA: EVIDENCE FROM INDONESIA

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ABSTRACT

The objective of this study is to explain the employee stock ownership program phenomenon in public companies in Indonesia. The ownership of companies in Indonesia is concentrated by a single controlling shareholder. Sometimes, the board of directors and board of commissioners of a company or his/her family are the controlling shareholders. This study is interested in describing the employment stock option program phenomenon. This study collects data from the Indonesian Stock Exchange database of companies conducting employee stock ownership programs. There were 45 companies conducting this type of program between 1999 and 2011. In 2011, the number of public companies listed on the Indonesian Stock Exchange was 451. This implies that about 9.97 percent of public companies conduct such a program. Why is it then, that more companies do not use this program? Almost 33.56% of public company directors in Indonesia are the family of the controlling shareholder. Therefore, he/she feels that this program will not have any impact on the manager because the manager has the same interest as the controlling shareholder. Thus, the program is not attractive in Indonesia as a way to reduce the agency problem between shareholders and manager. It is only relevant for public companies with dispersed ownership.

JEL: M41; G32

KEYWORDS: Employee Stock Ownership Program, Corporate Ownership, Concentrated, Dispersed

INTRODUCTION

Management practices used throughout the world can affect a company's practices in Indonesia. These practices generally occur in developed countries and include the employee ownership program. It is better known as Employee Stock Ownership Program (ESOP). This program is introduced by the management of human resources in the form of corporate ownership by employees. One objective of this program is to align the interests between agents (managers) and principals (owners). The alignment can reduce agency problems between owners and managers.

Engaging in this type of program is decided in a general meeting of shareholders, or the extraordinary meeting of shareholders, as in PT Garuda Indonesia Tbk. Based on a decision of the Extraordinary Meeting of Shareholders (EGM) of PT Garuda Indonesia Tbk, on November 15, 2010 as amended by Decision Circular Shareholders on January 26, 2011, the shareholders approved the ownership program by the management and employees (Management and Employee Stock Allocation/MESA). It was done by allotment of shares to the special buyer, which consists of stock bonus and stock discount. It also provides the option right to management and employees (Management and Employee Stock Option Plan/MESOP). Based on the approval of the shareholders, the directors set the number of shares for the MESA program at almost 5% of the total issuance of new shares and for the stock option program MESOP as much as 0.97% of the total issued and paid up shares after the public offering.

In Indonesia, accounting for these programs is set in the Statement of Financial Accounting Standards No. 53. The statement was effective from October 1, 1998. Stock options are offered as a reward to the employee. It is measured and recognized at the fair value of the instruments. The fair value of the

instruments can be determined by the service of the employee as a fair value, after deducting from the amount to be paid at the time of the equity instruments given (IAI, 2007).

According to Machfoedz (1999), a stock option is the right to buy shares at a special price. It is usually given to executives for their dedication to the company over a certain period. The employee stock option program is a program directed to provide an opportunity for employees to own stock in the company through stock options. Implementation of the ESOP in Indonesia is not yet optimal. Few public companies currently use this program. The question is why the program is not getting more response from the public companies in Indonesia. The program has some good objectives as follows: 1.) This program can provide rewards to all employees and directors, for their contribution to company performance. 2.) This program can help align the interests, between employees (directors) and owners (principals). 3.) This program can also increase employee motivation and commitment to the company because they are also the owner of the company. Therefore, the program is expected to increase productivity and performance. 4.) This program can be used to retain and motivate key employees and to enhance firm value.

Why then, has the program been used so little, by Indonesian Public companies? Is it concentrated ownership which reduces the take up? The objective is to answer these questions. The remainder of the paper is organized as follows. Section 2 discusses the relevant literature. Section 3 is research method. Section 4 provides analysis based data. Section 5 concludes the paper.

LITERATURE REVIEW

According to El-Tahch and Ricaurte (2011), employee stock option programs are the basis for developing a key employee in the present and future. Companies need to establish a work plan and a good blue print before establishing a basis. Philosophy and benchmarking is a blueprint and a plan to develop a company by an employee ownership program. It is critical to explain plans are intended to be achieved by the company as well as retaining key employees, paying a basic salary at a specific rate or an annual bonus on a certain level, and paying a basic salary or phantom stock.

Another important part prior the ESOP program implementation is a comparative study. This analysis uses market or industry survey data relating to other companies. How do they pay basic salary and annual bonus payments? We compare it with current pay practices in companies that will implement the ESOP. The study will provide an overview of the current picture of employee compensation and what is needed to respond to gaps between the company's compensation plan and the relevant benchmark.

The stock option program has several benefits as follows.

1. Stock option programs for employees can be used effectively, to reduce agency problems between owners (principals) and managers (agents). The program is expected to increase company performance. According to Iqbal and Hamid (2000), employee stock ownership increases the sense of satisfaction, commitment, and control of the company. An ESOP can also improve employee motivation and productivity for the company (Shulman, 2002).
2. The stock option program for employees is an effective way to reduce agency costs (Brenner, Sundarm, and Yermack, 2000). The costs can be mitigated through the alignment of interests between managers and principals. According to Chance, Kumar, and Todd (2000), this program can be used by public companies, to plan incentives and compensation for employees. McColgan (2001) suggests the structure of executive compensation contracts can be an incentive to increase firm value. It also influences the alignment of interests between owners and managers.

3. According to Senders (1999), ownership of shares by the employee will increase the performance of company and firm value. Iqbal (2000) finds that there is a positive association between operating performance of ESOP companies and the price market of stock of this company.
4. According to Carberry (1996), stock ownership by employees represents voting rights by the employees. Therefore, stock ownership can determine the percentage of their control of the company.
5. Cash flow advantages, an employee can contribute to a plan in the form of cash. The ESOP is required to invest primarily in ownership by employees. This cash flow advantage for companies is clear. Through an ESOP, employees receive a deduction equal to a fair market value of shares (Shulman, 2002).
6. An ESOP can be used to absorb funds from the public. Core and Guay (2000) suggest that when the problem of financial and capital needs arises, these companies will implement share-based compensation.

According to Bapepam (2002), Indonesian parties implementing the concept of stock ownership by employees, can be divided into two groups. The first group is public companies who have begun implementing a stock ownership program. The program is conducted through a special allocation program for employee or employee stock allocation, bonus shares or a bonus share plan, or provision of stock option or a stock option plan. Employee stock ownership plans, through program savings, or purchasing stock, are not yet a common activity in Indonesia. The second group is subsidiaries of multinational companies (foreign companies). Multinational companies compensate their employees in part through the ESOP program. It is also applied to employees of its subsidiaries in Indonesia, which are eligible to participate in this program.

According to Bapepam (2002), there are two main rules governing the implementation of ESOP in Indonesia as follows. 1. Bapepam. IX.A.7 suggests that employee get priority allotment for up to 10% of total public offerings. 2. Bapepam. IX.D.4 regulates that issuers can increase equity, without giving shareholders pre-emptive rights. Within a period of three years, additional capital can be more than 5% paid up. Based on the regulation, many issuers use this rule to increase the shares up to 5% of the total paid-up capital in the framework of the ESOP program.

This rule also regulates the disclosure required to increase equity without public offering, is limited only as follows. 1.) Analysis and discussion by management about financial conditions. 2.) Pro forma company. 3.) Effect of increasing equity to shareholders after adding equity and, 4.) The reason for the addition of equity without the order is the best option.

The company must also follow regulations governing the exercise price of the shares issued in adding equity without preemptive rights. The exercise price must be at least the market price of the stock in the regular market. It is the average closing price, during the period of 25 consecutive days before the announcement of a general meeting of shareholders, scheduled for adding equity.

The development of the implementation of ESOP in Indonesia is as follows (Bapepam, 2002). Prior to 1998, the ESOP is done by Indonesian companies. At the beginning, the ESOP is the allocation of shares when the company goes public. It is only a stock allocation scheme. In this offering, an employee obtains subsidies or loans guaranteed by the company. Since 1998, before a public offering, an employee is given warrants to purchase shares, at a future predetermined period and price.

Previous researchers observed positive effects of the employee stock ownership plan on operating performance, as documented by Park and Song (1995) and Blasi, Kruse, and Conte (1992). According to

Klien (1997), there are several theoretical perspectives relating to the ownership of companies by employees on employee behavior and corporate performance. Employee stock ownership will increase the employee commitment and performance of the company. According to Jensen and Meckling (1976), financial incentives, such as employee stock ownership, will align the interests of the employee and interests of shareholders.

Positive benefits obtained by employee-owners, is often cited as a primary motive to establish an ESOP. It suggests that an employee will be more motivated and act as owners through ESOP participation. The program also minimizes agency costs and aligns behavior with the goals of the firm. They will perform in their own best interest because they are not thinking as employees but as shareholders. Alignment of interest between agent and principle is of great benefit. This is a result of ESOP implementation. Therefore an ESOP has a significant impact on improving company performance.

Wah (1999) finds that total shareholder returns for ESOP firms, exceeded those of non ESOP firms by 6.9% and that average annual return on assets for ESOP was 2.7% higher than for industry peers without an ESOP. Wah (1999) uses 382 U.S. public firms that adopted ESOP over the period 1971-1995. Kruse and Blasi (2002) uses 343 matched pairs of ESOP and non ESOP held firms closely. Kruse and Blasi (2002) also compare performance differences from three years prior, to three years after introduction of the ESOP. Kruse and Blasi (2002) find differences in favor of ESOP of 2.4% in sales, 2.3% in employment, 2.3% in sales per employee, and 4.4% in employee productivity. Lee (2003) uses Taiwanese electronics manufacturers and finds similar productivity gains of 4-5% associated with the introduction of ESOP.

Pugh, Oswald and Jahera Jr. (2000), found that company performance, increased significantly for return against equity, return on assets and net profit margin, in the short term. Iqbal and Hamid (2000), examine the longitudinal relationship, between stock price changes and the operating performance of ESOP firms. They find a positive relationship between stock price changes and performance. They also find this relationship is significant on several quarters, after the changes in stock prices occurred.

Ducy, Iqbal, and Akhigbe (1997), examine the ESOP three year pre- and post-implementation economic performance, of publicly traded firms using operating cash flow (OCF), rather than accounting returns. Ducy, Iqbal, and Akhigbe (1997) determine that adjusted industry performance ESOP, deteriorated on all three measures: OCF to market value of assets, OCF to sales, and OCF per employee. According to Kruse, Freeman, Blasi, Buchele, and Scharf, (2003), the role of human resources policies and the motivation of ESOP employee-owners, are how employee ownership works successfully. It requires three analyses: incentives of ownership, availability of participative mechanisms and the corporate culture.

However, the executives can take advantage of the opportunities available, to increase earnings. They hope that the stock market price will increase (Baker, Collins, and Reitenga, 2002). This occurs because earnings information shows the company's performance. The information can also be used to predict the future performance of companies.

Managed earnings are known as earnings management. Some researchers in Indonesia such as the Asyik (2007) and Astika (2008) study the correlation between earnings management and ESOP. Asyik (2007) finds that company managers have the ability to manage earnings, around the option grant date. The effect is stronger when executives release earnings before the option grant date during the period prior to ESOP. For the period after ESOP, the effect is stronger relating to managing stock price volatility. This occurs because the volatility in determining fair value of options based on management policy.

Astika (2008) finds employee stock options granted, positively effect earnings management before the grant date. The results indicate that the more the option grant, the more likely they will be able to manage

earnings downward. Managers hope to lower the option exercise price. Astika (2008) also finds the number of exercised employee stock options, positively influenced earnings management before the exercised date. It indicates the more the exercised option, the more likely the manager, can manage earnings upward, before the exercised date, to take advantage of a higher stock price.

DATA

The samples in this study are from public companies that have implemented an ESOP. The companies are listed on the Indonesian Stock Exchange, in the period 1999-2011. Sampling was done by purposive sampling. Forty-five ESOP companies were available. The number of companies conducting ESOP is limited. There are 451 companies listed on the Indonesian Stock Exchange. This implies only 9.97% of public companies conduct an ESOP. Based on the facts, why do fewer companies utilize the ESOP program? The program has some advantages for both the company and shareholders. Is it caused by limiting rules in Indonesia, regulating the ESOP program? Or whether the concentrated ownership of the public companies, is causing the ESOP program to be less popular in Indonesia? These conditions will be discussed in the data analysis.

RESULTS

Based on the samples, the study analyzes the structure of corporate ownership. This study uses the ultimate ownership structure, to trace corporate ownership. To trace ultimate ownership, this study collects data from the Indonesian Business Data Center. It is caused by concentrated corporate ownership (Sanjaya, 2011). This study analyzes corporate ownership only for the manufacturing industry because data on the ultimate ownership of non-manufacturing companies is very difficult to find. Based on 45 companies conducting the ESOP program, the study identifies four companies included in the manufacturing industry, including PT Davomas Abadi Tbk in 2002, PT Dynaplast Tbk in 2003, Tbk PT Indofood Sukses Makmur Tbk in 2004, and PT Multistrada Arah Sarana Tbk in 2007. The following figures show the ownership structure, for each company as follows. Figure 1 shows the ownership structure of PT Davomas Abadi Tbk in 2002.

Based on the tracing in the chain of ownership, this study finds the controlling shareholder in PT Davomas is Hassoks Enterprise Ltd with a 23.17% ownership stake. Hassoks is a foreign company, for which we were unable to trace control. Hassoks' control rights to PT Davomas are 23.17% and cash flow rights are 23.17%. This result indicates that there is no agency problem between controlling shareholder and non-controlling shareholders in PT Davomas. Therefore, the number of control rights and cash flow rights are the same, or cash flow rights leverage is zero. Cash flow rights leverage can be used as a proxy for determining the agency problems. Cash flow rights leverage is control rights minus cash flow rights. PT Davomas is controlled by foreign institution.

The compositions of the board of directors and commissioners of PT Davomas on December 31, 2002 are as follows:

Board of Directors	Board of Commissioners
President Director: Johannes Herkiamto	President Commissioner: Hermawan Felani
Director: Theodorus Hopmans	Independent Commissioner: Anthonius A. Unawekla
Director: Berliana Sukarmadidjaja	Commissioner: Elfisno

Board of directors and commissioners are professional people. During the tracing of the chain of ownership in PT Davomas, this study is unable to find, the names of families associated with directors and commissioners.

Figure 1: Ownership Structure of PT Davomas Abadi Tbk in 2002

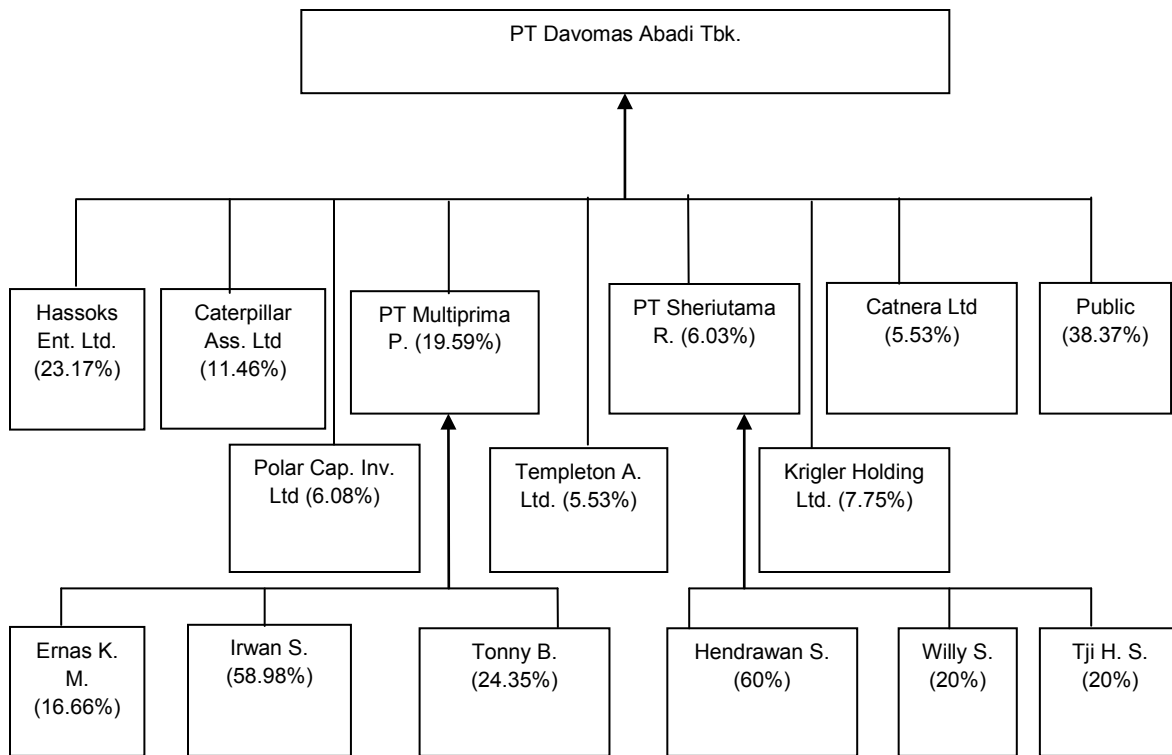


Figure 1 shows the ownership structure of PT Davomas Abadi Tbk. There are direct and indirect ownership on the structure. Hassoks is a controlling shareholder of PT Davomas Abadi Tbk. The control rights of Hassoks in PT Davomas Abadi Tbk are 23.17%. Cash flow rights of Hassoks in PT Davomas Abadi Tbk are 23.17%.

Figure 2 shows the ownership structure of PT Dynaplast Tbk in 2003. Based on the chain of ownership in PT Dynaplast Tbk, the controlling shareholder in this company is the Bank of Bermuda Ltd. Hong Kong. The percentage of shares, owned by Bank of Bermuda in PT Dynaplast is 39.80%. Bank of Bermuda is a foreign company we could not trace who controls the bank. Bank of Bermuda has control rights as well as cash flow rights in PT Dynaplast (39.80%). This suggests, that agency problems between controlling shareholders and non-controlling shareholders are low or absent. It indicates the value of cash flow rights leverage is zero. PT Dynaplast is also controlled by a foreign institution.

The compositions of the board of directors and commissioners of PT Dynaplast on December 31, 2003 are as follows:

Board of Directors

- President Director: Tirtadjaja Hambali
- Director: Gunawan Tjokro
- Director: Mulyadi Kosasih

Board of Commissioners

- President Commissioner: Soebekti Hambali
- Commissioner: Robert Wiryono
- Commissioner: Santoso Symkoputro
- Commissioner: Sri Hartini Urip S.

The President Director and Commissioner of PT Dynaplast is the second controlling shareholder. They are the largest controlling shareholder, after the Bank of Bermuda. Their control rights and cash flow rights are 26.58%. The number is still lower than the control rights and cash flow rights of Bank of Bermuda. The objective of ESOP in this company is to motivate corporate executives, to work better for the company. Performance improvement will increase the value of the firm. It will also improve the welfare of both owners and managers. Agency problems in PT Dynaplast are low. It encourages

alignment between the controlling shareholder and non-controlling shareholders, such as Bank of Bermuda and Hambali's family and other non-controlling shareholders.

Figure 2: Ownership Structure of PT Dynaplast Tbk in 2003

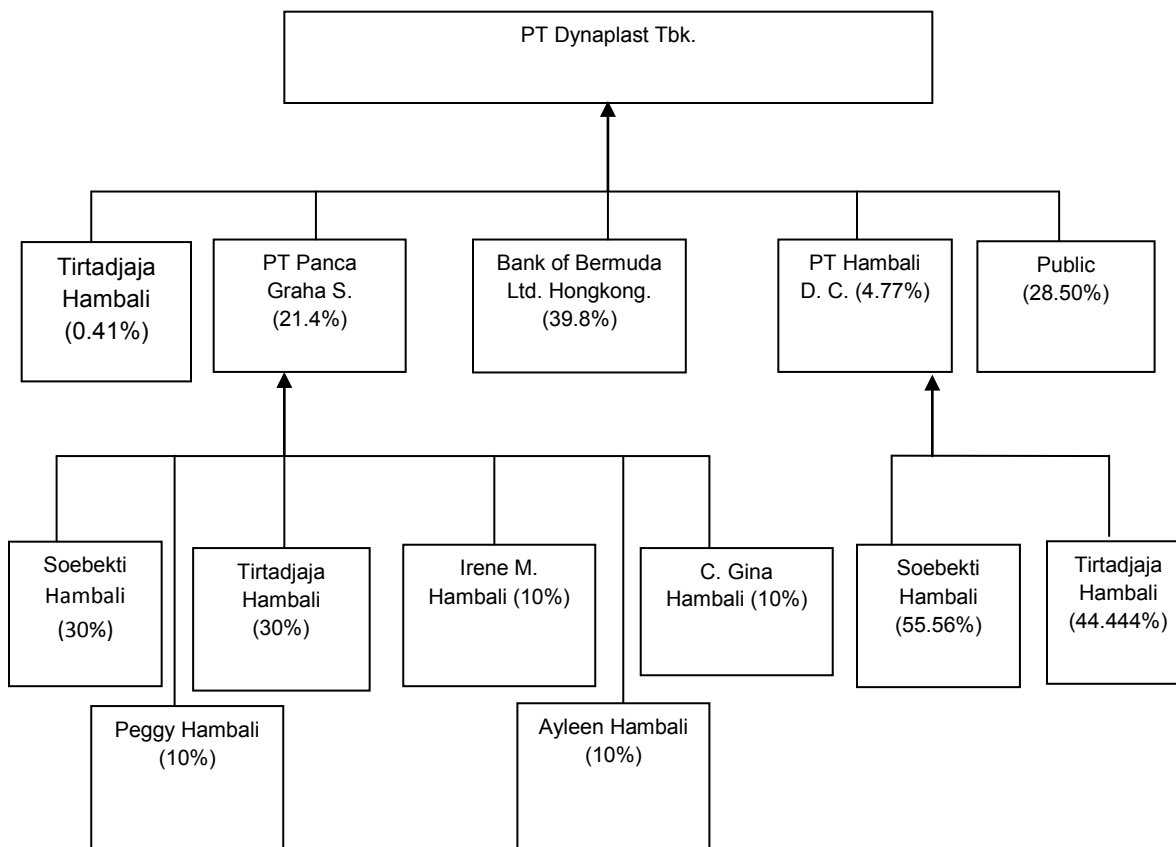


Figure 2 shows the ownership structure of PT Dynaplast Tbk. There are direct and indirect ownership on the structure. Bank of Bermuda is the first controlling shareholder of PT Dynaplast Tbk. The control rights of Bank of Bermuda in PT Dynaplast Tbk are 39.80%. Cash flow rights of Bank of Bermuda in PT Dynaplast Tbk are 39.80%. The second controlling shareholder of PT Dynaplast Tbk is Hambali's family. They have the control and cash flow right is the same (26.58 %).

Figure 3 shows the ownership structure of PT Indofood Sukses Makmur in 2004. Based the chain of ownership in PT Indofood Tbk, we find the controlling shareholder is First Pacific Company Ltd. The percentage of shareholding by First Pacific Company Ltd. in PT Indofood is 46.53%. First Pacific Company Ltd. is a foreign company and we were not able to trace who controls the company. Control rights of First Ltd. in PT Indofood are 46.53%. Cash flow rights of First Ltd. are 46.53%. These results show that there is no agency problem between the controlling shareholder and non-controlling shareholders in PT Indofood. This occurs because the control rights and cash flow rights are equal, or cash flow rights leverage is zero. PT Indofood is controlled by a foreign company.

Figure 4 shows the ownership structure of PT Multistrada Arah Sarana Tbk in the year 2007. Figure3 4 shows PVP XIII Pte Ltd. is the controlling shareholder. In PT Multistrada, agency problems are low and almost nonexistent. The control rights of PVP XIII Pte Ltd. are equal to its cash flow rights. We could not trace who owns PVP XIII Pte Ltd. PVP XIII Pte Ltd. is a foreign company. Thus, PT Multistrada is controlled by a foreign company.

Based on these four manufacturing companies, ESOP in Indonesia is only conducted by companies owned by foreigners. ESOP is conducted in companies which have the low agency conflict between the controlling shareholder and non-controlling shareholders. It is shown, by the value of cash flow right leverage equal to zero. The leverage can be used as a proxy for agency conflicts between controlling shareholder and non-controlling shareholders on concentrated ownership.

Figure 3: Ownership Structure of PT Indofood Sukses Makmur Tbk. in 2004

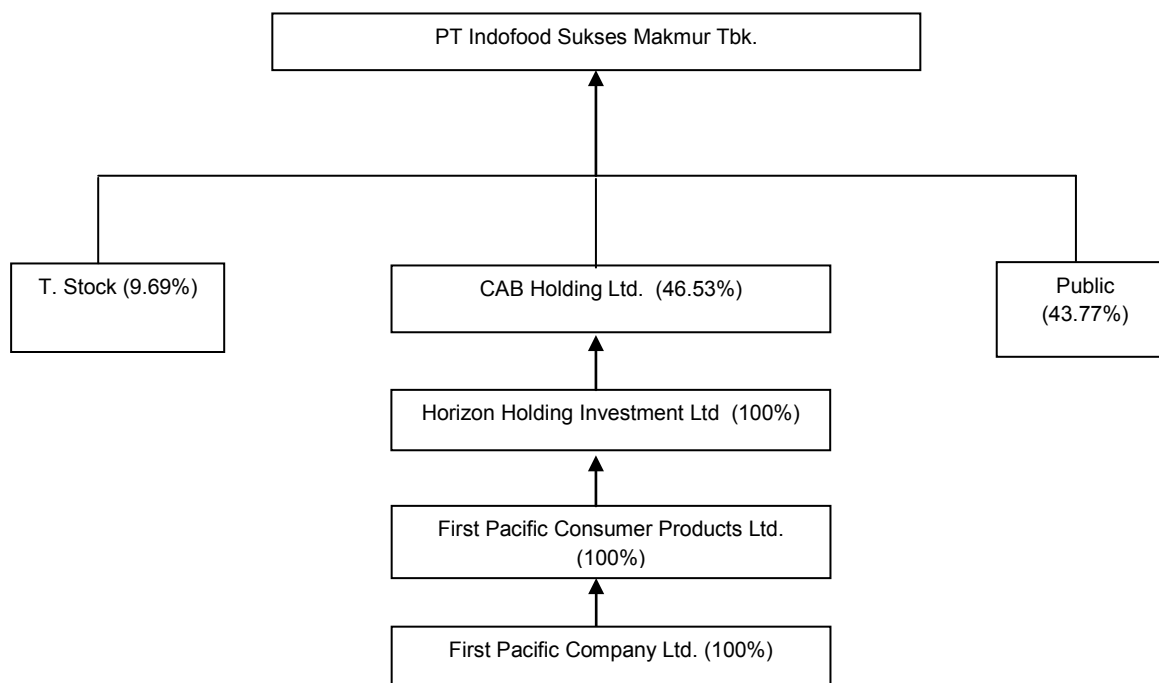


Figure 3 shows the ownership structure of PT Indofood Sukses Makmur Tbk. There are direct and indirect ownership on the structure. First Pacific Company Ltd. is a controlling shareholder of PT Indofood Sukses Makmur Tbk. The control rights of First Pacific Company Ltd. in PT Indofood Sukses Makmur Tbk are 46.53%. Cash flow rights of First Pacific Company Ltd. in PT Indofood Sukses Makmur Tbk are 46.33%.

The next discussion is why the ESOP programs are less popular in Indonesia? Though, this program has several benefits, such as reducing the agency problem between principals and agents. Another objective of ESOP is to align the interests, between managers and owners. The alignment will improve the employee performance. It can also increase the value of the firm. It will give a positive impact on the welfare of both the employee and the employer. Why is this program not popular in Indonesia?

Sanjaya (2011) shows that public companies which are not owned by ultimate or direct ownership (immediate) is 3.79% of all manufacturing companies, listed on the Indonesian Stock Exchange during 2001-2007. There are 96.21% of manufacturing companies, which are owned by ultimate ownership. Companies which have dispersed ownership are cut off at less than 10% of control rights and include 0.49%. Based on the 10% cut off, 99.51% of manufacturing companies have concentrated ownership. The results confirm that only 0.49% of manufacturing companies are dispersed.

Sanjaya (2011) also suggests the family is the greatest controlling shareholder at 68.49% . This finding is consistent with La Porta, Lopez-de-Silanes and Shleifer (1999), Claessens, Djankov and Lang (2000), Faccio and Lang (2002), and Siregar (2006). The Indonesian government only controls 2.58% at a 10%.

cut off rate. The results differ little from Siregar (2006). Other controlling shareholders control 28.93% at a 10% cut off. Other controlling shareholders include foreign investors, cooperatives and employees.

Figure 4: Ownership Structure of PT Multistrada Arah Sarana Tbk. in 2007

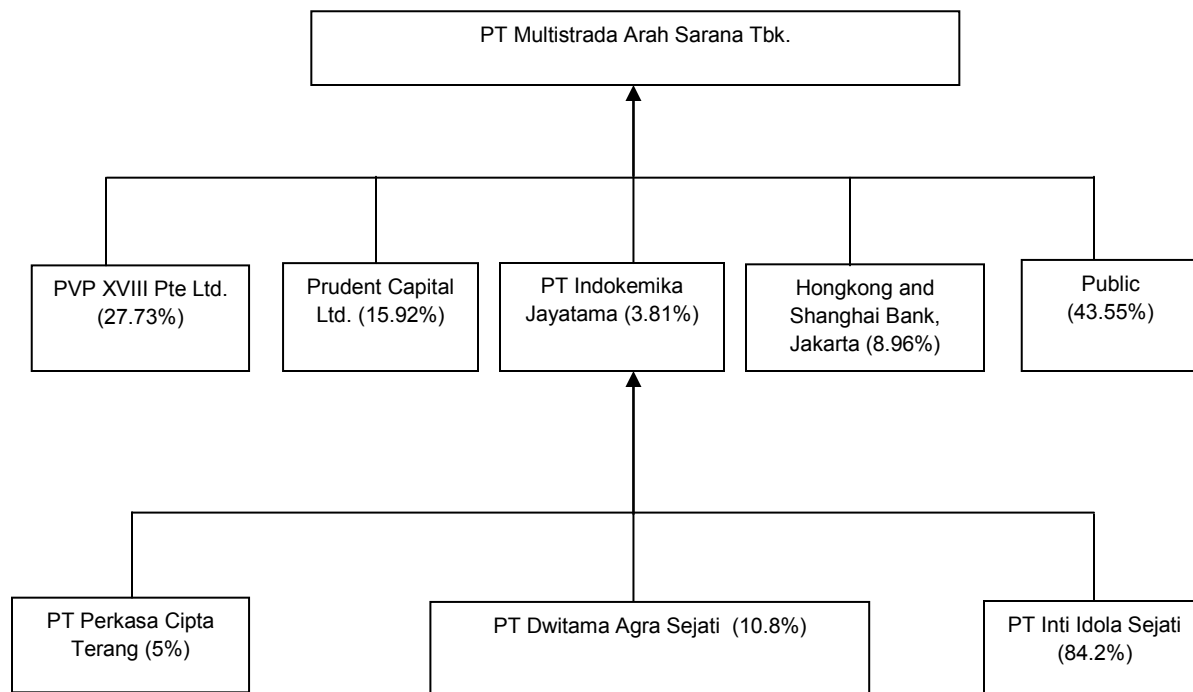


Figure 4 shows the ownership structure of PT Multistrada Arah Sarana Tbk. There are direct and indirect ownership on the structure. PVP XIII Pte Ltd. is a controlling shareholder of PT Multistrada Arah Sarana Tbk. The control rights of PVP XIII Pte Ltd. in PT Multistrada Arah Sarana Tbk are 27.73%. Cash flow rights of PVP XIII Pte Ltd. in PT Multistrada Arah Sarana Tbk are 27.73%.

Siregar (2006) shows 437 of 1302 observations on a categorical variable rate 1 for management. This result indicates that 33.56% of controlling shareholders are also the directors of public companies. This means that directors of public companies are the controlling shareholders, or the family member of a controlling shareholder. Involvement in the board of directors is another way to improve the control mechanisms other than through ownership pyramids or cross-ownership.

In this circumstance, the ESOP program is not important because without this program, directors have aligned their interests with shareholder interests. Directors may not make decisions that will harm their family members. The phenomenon of agency problems in Indonesia is different from the phenomenon of agency problems in the U.S. or the U.K. Agency problems occurred in Indonesia, between controlling shareholder and non-controlling shareholders. ESOP programs become less relevant when applied in this context. ESOP programs are more effectively implemented in dispersed ownership, where managers are the company controllers. Agency problems that occur are usually between management companies and owners.

An ESOP program becomes very relevant and appropriate when implemented in the context of dispersed ownership. The objective of the program is to reduce agency problems and to improve the performance of each employee. Meanwhile, for companies with concentrated ownership, the ESOP program is a less effective means to reduce agency problems. This is due to agency problems which occurred between controlling and non-controlling shareholders. How does the ESOP program align the interests between controlling shareholder and non-controlling shareholders? It can not be done easily. However, this

program can be done within the context of concentrated ownership. This program can be implemented in companies which do not have agency problems, between controlling shareholder and non-controlling shareholders. The ESOP program is a strategy to make managers more serious and committed to their jobs. It is a way which is mutually beneficial for all parties existing in the company.

CONCLUSION

The objective of this study is to explain the phenomena of the employee stock ownership program in public companies in Indonesia. This study describes the employment stock option program phenomenon. Sampling was done by purposive sampling. Forty-five companies conducted ESOP programs between 1999 and 2011. In 2011, the number of public companies listed on the Indonesian Stock Exchange was 451. This implies 9.97% of all firms used an ESOP.

This study concludes the ESOP program is less attractive for implementation in Indonesia. It is caused by company directors who are controlling shareholder or family member of a controlling shareholder. Second, ownership of companies in Indonesia is concentrated in certain groups such as family. Family is the most dominant controller of public companies. Third, agency problems in Indonesia occur between controlling and non-controlling shareholders. These conditions make the ESOP program less popular in Indonesia. Thus, the program is not attractive in Indonesia as a way to reduce agency problems between shareholders and managers. It is only relevant for public companies with dispersed ownership.

The ESOP program is effectively implemented in situations with dispersed ownership. Agency problems occur in dispersed ownership between managers (agent) and owners (principles). To reduce this problem, the ESOP program can be implemented. This program aligns interests between managers and owners. In the context of concentrated ownership alignment occurs between managers and owners. It occurs because the manager is a family member of the owners. In this situation, the managers will not make decisions to benefit themselves and harm the owner. If it is done, the manager also harms their families.

Limitations of this study are, firstly this study only describes the phenomena existing in Indonesia. Secondly, this study is limited to the context of Indonesia. Thirdly, private ownership in some companies abroad cannot be traced. Subsequent studies might consider aspects of ownership when conducting research on ESOP. Previous studies can be developed by considering the agency problems occurring in Indonesia. Future studies can also compare the ESOP phenomenon in some East Asian countries.

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THE RELATIONSHIP BETWEEN STRUCTURAL EQUATION MODELING AND BALANCED SCORECARD: EVIDENCE FROM A SWISS NON PROFIT ORGANIZATION

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Alexandru Stancu, University of Geneva and IATA
Christophe Jeannette, University of Geneva

ABSTRACT

This paper studies the relationship between structural equation modeling and Balanced Scorecard in a Swiss non-profit establishment. Using financial and non-financial performance indicators collected directly from the organization, the paper proposes a rational construction and analysis of Balanced Scorecard by selecting the factual metrics for the right strategic areas. This choice is made by applying a sequence of Partial Least Squares in the proposed model. Furthermore, the approach establishes the cause-and-effect sequence originally defined by Kaplan and Norton as: the measures of organizational learning and growth will influence the measures of internal business processes, which, sequentially, will impact the measures of the customer perspective that, lastly, will affect the financial indicators. It will be noted that the Kaplan and Norton model of Balanced Scorecard is different from the findings in this study, a case somehow too general to handle today's complex market environment. Following this, the paper puts forward a time-managed approach to identify the evolution of the main contributors to the current company's strategy as well as their behavior in the future organizational performance. This approach will be applied and demonstrated in a detailed real case of a Swiss non-profit organization.

JEL: G39, M19, M40, L31

KEYWORDS: Balanced Scorecard, Key Performance Indicators, Performance Measurement, Structural Equation Modeling (SEM), Partial Least Squares (PLS), Principal Component Analysis (PCA), Non-profit Organization

INTRODUCTION

An innovative approach of strategic management was introduced in the early 1990s by Robert Kaplan from Harvard Business School and David Norton, co-founder and president of Balanced Scorecard Collaborative Inc., based in Boston, USA. They named this approach the Balanced Scorecard (BSC). Pinpointing some of the drawbacks and ambiguity of previous management systems, the BSC method proposes a coherent guidance as to what companies should measure in order to “balance” the financial perspective. The BSC summarizes a series of performance indicators that offers executives a quick but comprehensive representation of their business. The BSC includes financial indicators that illustrate the outcomes of actions already taken and it complements the financial measures with operational indicators on customer satisfaction, internal processes, and the company's innovation and development activities – “operational measures that are the drivers of future financial performance” (Kaplan & Norton, 1992).

However, one of the limitations of the BSC lies in its structure. Despite the fact that the authors provide us with some key points and describe the steps for building the BSC, the concepts are rather ambiguous and can be difficult to apply in an organizational environment. There are three main goals in this study. The first goal is to merge the above concepts and try to advance several statements for a

representative construction of a BSC using the Partial Least Square (PLS) technique. The objective is to generate a realistic model that can be applied in any organization environment, thus modeling the concept of BSC. The second goal is to validate the assumptions with a nonprofit organization case where performance indicators selected will outline the different strategic perspectives, and a rational explanation for this selection is established. A cause-and-effect structure will be generated and clarifications made as to which strategic perspectives (latent variables) are influencing and which are to be influenced. One of the main conclusions of this example is that the Kaplan and Norton's model of BSC is nothing more but a particular case of our conclusions. The final aim is to closely monitor on a timely basis the upmost indicators that affected the organizational performance, indicators that will shape the future company's strategy. The paper is structured as follows.

In the next section, the main BSC concepts are presented and underlined from the specialized literature. The "idealistic" process of 4-axes construction is then highlighted followed by a logical structure allowing for the identification of the number of strategic perspectives as well as the performance indicators connected to each perspective. A tentative modeling of BSC that can be implemented in any organization environment is put forward. This is pursued by a real example of a nonprofit establishment in which the PLS method is applied in order to build a coherent BSC. Using this information, one will be able to better predict the future company trends and to take enhanced corrective measures to quickly adapt in a challenging and complex organizational environment. Finally, the paper will conclude with several comments and remarks that underscore the major outcomes of this work.

LITERATURE REVIEW

According to Kaplan and Norton, the BSC is a management tool (not only a measurement model) that enables companies to acknowledge their vision and strategy and convert into action. Consequently, the BSC allows top management a thorough compilation that translates the organizational strategic goals into a coherent set of performance measures. It provides response across the internal company processes as well as external results in order to constantly advance strategic performance and outcomes. When completely set up, the BSC converts strategic planning from an abstract task into the fundamental point of an organization. As mentioned by Fielden's (1999), companies worldwide start on influencing the ability of BSC for translating vision and strategy into measurable objectives. In fact, a recent study approximates that 60 percent of Fortune 1000 companies have tested the BSC (Silk 1998). Adopters involve KPMG Peat Marwick, Allstate Insurance, and AT&T (Chow et al. 1997).

The BSC can manage the base of the organization's efforts in identifying and communicating the crucial key interests to managers, employees, investors and even customers (Kaplan & Norton, 1993). With four strategic perspectives, the BSC reduce information excess by controlling the number of measures used and compels executives to concentrate on the handful of performance indicators that are most essential. Accordingly, it enables companies to contour financial results while simultaneously monitoring the resources and obtaining the intangible assets they would need for future development (Kaplan & Norton, 1996). The BSC poses managers with the facility to identify performance indicators that could accurately predict the wealth and health of an organization. By allowing the capacity to decode strategy in rapid and quantifiable actions, a BSC manages strategy in an organizational environmental and unveil hidden assets and information. Furthermore, by connecting both internal and external people with these strategies, recurrent learning and development can be achieved (Pineno, 2002).

The BSC asserts to recognize cause-and-effect links between the various constituents of an organization (Kaplan & Norton, 1996). From a practical perspective, this represents the essence of the balanced scorecard, enclosing result metrics and performance drivers, related together in a cause-and-effect relationship. In fact, the heart of the model is this hypothesis allowing measurements in non-financial domains to be utilized to forecast future financial performance (Nørreklit, 2000).

In the eyes of Bontis and al (1999), the BSC has three major benefits. First, it operates according to a straightforward and effectual logic, simple to be learnt by the executives. Second, it seeks to establish clear relationships between the financial performance and the indicators. Third, the topic literature is consistent, both theoretically and practically.

However, the BSC has a couple of drawbacks with some of its key assumptions and relations. Firstly, Nørreklit (2000) states that there is not a causal but rather a sound connection between the strategic areas analyzed. Furthermore, the author contends that customer satisfaction does not automatically create superior financial outcomes. Sequences of action that produce a high ratio of customer value at low costs will eventually lead to good financial results, but this is not an issue of causality; it is commonsense since it is integrated in the concepts. Consequently, the BSC makes illogical suppositions, which may conduct to the anticipation of incoherent measures, causing sub-optimal performance. In addition, the BSC is not a representative strategic management tool mainly because it does not certify any rapport between organizational and environmental reality (e.g. competition). As a result, a discrepancy must be accepted between the strategy formulated in the actions actually undertaken and the assumed strategy (Nørreklit, 2000). Kanji (2002) summaries further of the BSC weaknesses highlighting that the model is way too abstract and not easy to transform into a measurement model, the links between criteria are not clearly stated and, lastly, the causal relationships are problematic (more like interdependence).

Finally, Malina & Selto (2001) argues that the BSC is very complicated to put into practice. The authors make observations on how some aspects negatively influences opinions of the BSC and instigates important controversy and friction between the organization and its distributors. They further concluded that the metrics used in the model are biased or inaccurate, the communication about the BSC is strictly top-down (i.e., one-way and not participative) and the benchmarks are inappropriate but employed for assessment.

The Need for a New Validation Approach

Within this broad-spectrum environment of ambiguity and criticism, some authors (Shields, 1997; Shields & Shields, 1998) have called on management accounting researchers to make better use of Structural Equation Modeling (SEM). Structural Equation Modeling is a statistical technique comprising a family of different methods (path analysis, Partial Least Squares models and latent variable SEM) that allows the simultaneous analysis of a series of structural equations. However, there appears to be some consensus that all SEM involve two characteristics: first, the estimation of multiple interrelated dependent relations between variables, and second the ability to represent latent variables in these equations while accounting for estimated measurement error connected to the unsatisfactory measurement of variables. These methods are particularly helpful when a dependent variable in one equation turn into an independent variable in another equation (Hair et al., 1998).

An essential concern to log is the need of a significant sample size for the majority of SEM models. A suggested rule of thumb for latent variable SEM is a minimum sample size of 100 (Medsker et al., 1994). Furthermore, it has been advised that a sample volume of 200 may be required to produce valid fit measures and to prevent making inaccurate conclusions (Marsh, Balla, & McDonald, 1988; James & James, 1989; Boomsma, 1982; Medsker et al., 1994). In spite of these concerns, Smith and Langfield-Smith (2004) conclude in one of their management studies that eleven of the 20 surveys (55%) had sample volumes beneath the accepted threshold of 200. Even if the recommended sample size of 100 is considered the lowest bound of tolerability, three of the 20 researches (Magner, Welker, & Campbell, 1996, Chalos & Poon, 2000, Abernethy & Lillis, 2001) fall underneath this level, denoting that the conclusions drawn from these studies could be questioned.

As a result of that, management accounting researchers may be restrained from using covariance based methods caused by the significant sample size requirements, and puts forward the statement that the technique is only appropriate in areas where theory is relatively robust. Despite the fact that these shortcomings are true for latent variable SEM techniques, Partial Least Squares (PLS) modeling presents an alternative. Compared to others, PLS regression is a fairly recent technique that generalizes and merges features from principal component analysis (PCA) and multiple regressions. It is specifically useful when require predicting a series of dependent variables from a (very) large sequence of independent variables (i.e., predictors). It was employed in the social sciences (specifically economics, Herman Wold 1966) but became popular first in chemometrics (i.e., computational chemistry) due in part to Herman's son Svante, (Geladi & Kowalski, 1986) and in sensory evaluation (Martens & Naes, 1989). However, PLS regression is also becoming an alternative in the social sciences as a multivariate method for non-experimental and experimental data alike (neuroimaging, see McIntosh, Bookstein, Haxby, & Grady, 1996). It was first pioneered as an algorithm similar to the power method (used for calculating eigenvectors) but was rapidly retained in statistical milieu (Hervé, 2003).

The usage of PLS, despite of its intrinsic limitations (specifically that it is a limited-information method, aimed to maximize prediction, rather than fit), figures out to be a way in which statistical modeling in management accounting research can move forward without the requirement to obtain large samples, something which management accounting researchers have usually found problematic. Another benefit of PLS is the method's ability to accommodate non-normal data, triggered by less demanding assumptions behind the technique (Smith & Langfield-Smith, 2004). Nevertheless, there is some misunderstanding in the terminology utilized in the PLS field. Herman Wold first introduced the notion of Partial Least Squares in his study about principal component analysis (Wold, 1966) where the NILES (nonlinear iterative least squares) algorithm was developed. This algorithm (and its extension to canonical correlation analysis and to specific situations with three or more blocks) was afterwards called NIPALS (nonlinear iterative partial least squares) (Wold, 1973; Wold, 1975). The notion of "PLS approach" is somewhat too broad and combines PLS for path models on one side and PLS regression on the other. Following a suggestion by Martens (1989), this study exploits the term PLS for Structural Equation Modeling to designate the use of "PLS Path Modeling" as illustrated in Figure 1.

Relationships between the observed variables and the latent variables (outer model) Each latent variable ξ_j is implicitly explained by a group of observed variables x_{jh} . Each observed variable is related to its latent variable by a simple regression:

$$x_{jh} = \pi_{jh0} + \pi_{jh}\xi_j + \varepsilon_{jh} \tag{1}$$

Relation between the latent variables (inner model)

The causality model leads to linear equations connecting the latent variables:

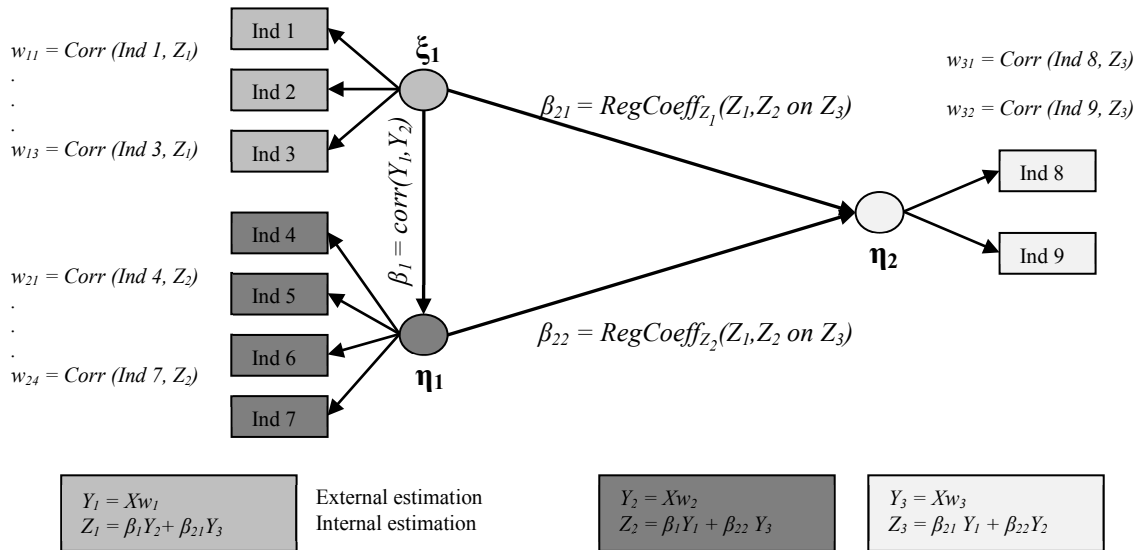
$$\xi_j = \beta_{j0} + \sum_i \beta_{ji}\xi_i + v_j \tag{2}$$

The latent variables related to ξ_j are divided into two categories: the precursors of ξ_j which are latent variables affecting ξ_j and the successors which are latent variables affected by ξ_j .

For any precursor ξ_i of the latent variable ξ_j , the inner weight e_{ji} is equivalent to the regression coefficient of Y_i in the multiple regression of Y_j on all the Y_i 's connected to the precursors of ξ_j . If ξ_i is

a successor of ξ_j then the inner weights e_{ji} is equivalent to the correlation between Y_i and Y_j (Tenenhaus & Vinzi, 2004).

Figure 1: Example of PLS Path Modeling



Variables are normalized after each step iterate until convergence

Above figure describe the two key relations found in any PLS path model: a first one named the outer model, illustrating the connections between the latent variable and its manifest variables and a second one called the inner model defining the relationships among the latent variables themselves.

The available software has been for many years LVPLS 1.8 developed by Lohmöller (1987, last existing version). Lohmöller has broadened the basic PLS algorithm in numerous ways and published all his research outcomes in 1989. More recently, updated software have been elaborated by Wynne Chin (2001, for the last version) entitled PLS-Graph 3.0 and Christian Ringle labeled SmartPLS. Besides the user-friendly graphical interface to PLS, the algorithm has been further refined and improved with major options being added, like cross-validation of the path model parameters by jack-knife and bootstrap amongst others. Bootstrapping is the technique of gauging components of an estimator (for example its variance) by measuring those aspects when sampling from an estimating distribution.

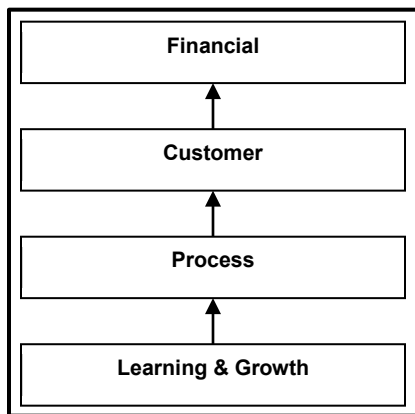
One typical option for computing distribution is the observed distribution of the empirical dataset. In the situation where a group of observed variables are assumed to be from an identically and independent distributed population, this can be solved by creating a number of resamples of the observations (and of same size of the observations), each of which is achieved by random sampling with replacement from the initial set of data. The benefit of bootstrapping compared to analytical techniques is its high simplicity - it is significantly easy to use the bootstrap in order to find estimates of standard errors and confidence intervals for complex estimators of the distribution, such as percentile points, proportions, correlation coefficients and odds ratios. However, even if more, newer and more complex PLS programs are available today (e.g. SmartPLS), a greater examination of the PLS Path Modeling permitted us to develop our own software from scratch with the aim of computing the principal component analysis, path weighting scheme and the bootstrap validation procedure with one tool.

Bonding Balanced Scorecard with Partial Least Squares

Ittner and Larckner concluded in 1998 that "(...) decisions using multicriteria performance measurement systems should be computed using explicit, objective formula that prescribes the weights to be attached to each measure, or should be based on subjective evaluations where the weights to be attached to each measure is implicitly or explicitly chosen by the decision maker". This should be always considered when building, checking and validating assumptions of causality relationships between the performance indicators within the context of the BSC implementation in a company. While this might seem difficult from a practical perspective, the PLS technique offers a valid solution.

As shown in Figure 2, the initial statements of causality relationships between the four strategic perspectives of the Kaplan and Norton's BSC remain subjective. The use of a structural equations model is recommended to establish, in a more objective way, the intensity of the relations between the latent variables defined by groups of observed or measurable indicators. Indubitably, whereas the choice of the perspectives and the hypotheses that link them remain biased in the case of Kaplan and Norton, the model of structural equations aims "to provide a meaningful and parsimonious explanation for observed relationships within a set of measured variables" (MacCallum, 1995).

Figure 2: Generic Relationship Map (Kaplan and Norton 1996)



This figure illustrates the original cause-and-effect chain as defined by the Kaplan and Norton (1996), starting from the learning and growth perspective that will affect the measures of internal business processes which sequentially will influence the measures of the customer perspective which, finally, will affect the financial area.

In a structural equations approach the latent variables cannot be assessed in a direct and precise way. Consequently, these latent variables require measurable variables, which are described through performance indicators that can be directly observed and evaluated. The structural equations method is derived from the principal component analysis of the data (confirmatory or exploratory, in line with each specific case) to distinguish and validate the model of the causal relationships which represent the focal point of BSC. It is essential to highlight that one of the restrictions intrinsic in the application of a system of structural equations in the BSC milieu, are the statistics requirement expected for the data validation, which compels a significant quantity of observations in order to validate the results achieved. The gathering of a large series of data is not easy, particularly in small and medium-sized firms. This is why the use of PLS presents a huge benefit in this particular case or in any case where large datasets are not available.

A Pragmatic Case: Example of a Non-Profit Organization

The suggested method of this study, although universally applicable to any kind of organization, is presented using an example of a non-governmental and non-profit institution. Based in Geneva,

Switzerland, this international governmental organization has associative statute active at multinational levels in the field of human rights protection. Devoted to the primacy, the coherence and the application of the international law and the principles that make progress in the human rights field, the association is joining the national and international lawyers, offering their competences in regards to legal expertise for promotion and defense of the previously mentioned rights. The organization has branches in regional offices of Thailand, Nepal, Guatemala and South Africa and is employing a total of around 40 people.

When fully implemented, the proposed method for BSC construction using PLS approach will allow the following: 1.) Identifies the vision and strategy by highlighting the crucial performance indicators. The stress is laid on the fact that financial measurements must be “balanced” with non-financial measurements, coming from other strategic perspectives, 2.) Helps retaining only the key performance indicators dependent on the objectives of the strategic perspectives, while seeking to define the sequences of actions that ultimately create the success of an organization. 3.) Once the strategy and key actions are seized, the organization defines its crucial competences, essential to the development and the improvement of the processes relative to its strategic success. 4.) Finally, it permits the construction of a BSC adapted to the various hierarchical levels, while fixing of short and long-term objectives for the various key indicators.

In a nutshell, there are five chronological main steps proposed in this study, at the end of which will allow the construction and implementation of a rational and optimal BSC: (1) gather historical data from the organization, (2) organize and prepare the final database, (3) ascertain and define the numbers of strategic perspectives and performance indicators connected to those, (4) assemble the cause and effect link between all strategic perspectives and, lastly, (5) employ and operate this management tool for long-term planning. As showed in Figure 3, *the first step* is associated with the collection of all historic key performance measures throughout the organization. Even though this seems a simple assignment, it actually entails a massive time gathering the metrics employed in the institution, particularly building a valid historic database. This exercise is crucial and will directly affect all of the following steps. Applying this step in the selected organization resulted in a total of 54 variables summarizing their evolution over 12 periods on a quarterly basis (3 years).

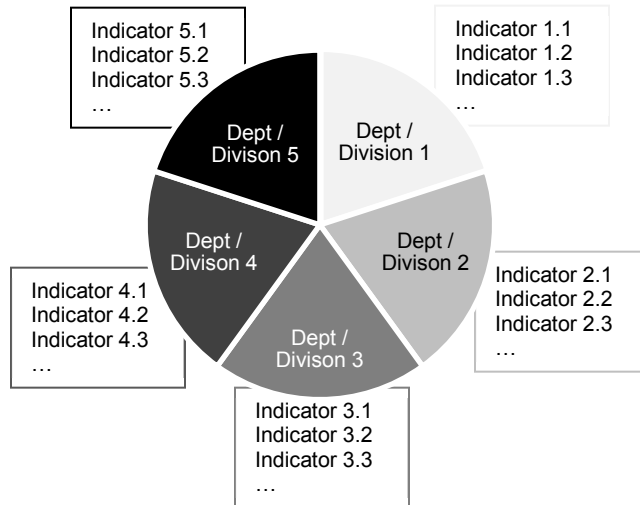
Taking into account the sizeable database of indicators, *the second step* is related to the final cleaning of the database (Table 1). As stated previously, the collected measures could contain errors and will potentially pollute the findings. Consequently, the variables should be characterized by (a) reliability and consistency, (b) same occurrence in time, (c) ability to capture a fraction of the organizational current strategy, (d) information singularity and (e) clarity and straightforwardness. This step is achieved through consistent analysis and intense top management consultations and will ensure that the retained performance indicators are the key drivers of the organization. After this step only 48 variables from the non-profit organization have finally been kept.

However, albeit this rational managerial selection has been employed, the company still has a large database, which is quite challenging to administer for the BSC construction. As illustrated in Figure 4, *the third main step* is to filter and congregate the variables within specific axes (or strategic perspectives) able to encapsulate a part of the organization’s performance. There are three main attainments in performing this step: first is to generate the number of strategic axes summarizing an acceptable level of the total company’s performance, second is to filter each axis and retain only the performance indicators that are highly correlated, disregarding any unnecessary and irrelevant information and, third is to label these assemblies of indicators by studying the nature of information that gravitates each strategic perspective or axis.

Several existing statistical methods are able to accomplish this classification. Both factor analysis and principal component analysis (PCA) can be applied for this step. Although different, the two techniques

are often mixed up, though factor analysis becomes equivalent to PCA if the "errors" in the factor analysis model are supposed to all have the same variance. Principal component analysis can be used for dimensionality reduction in a dataset by preserving those characteristics of the data that influence most its variance and by keeping lower-order principal components and disregarding higher-order ones. Such low-order components regularly summarize the "most important" features of the dataset. Factor analysis on the other hand, is a statistical technique employed to describe variability among analyzed variables in terms of fewer unobserved variables called factors. Factor analysis assists in identifying "factors" that explain a diversity of results on distinct tests.

Figure 3: Identifying and Gathering Company’s Performance Measures



Above figure shows an example of an organization with its various departments or divisions. After a careful analysis all performance measures will need to be identified and subtracted with the help of the main business owners.

Table 1: Example of Cleaning and Setting Up the Final Database

Strategic Performance Indicators Database					
Time series	Ind 1.1	Ind 1.2	Ind 1.3	...	Ind zz.yy
Month 1	x	x	x		x
Month 2	x	x	x		x
Month 3	x	x	xxx		x
...		x	x		x
Month n		x	x		x

Missing variables (pointing to empty cells in Ind 1.1 for Month 3 and Month n)

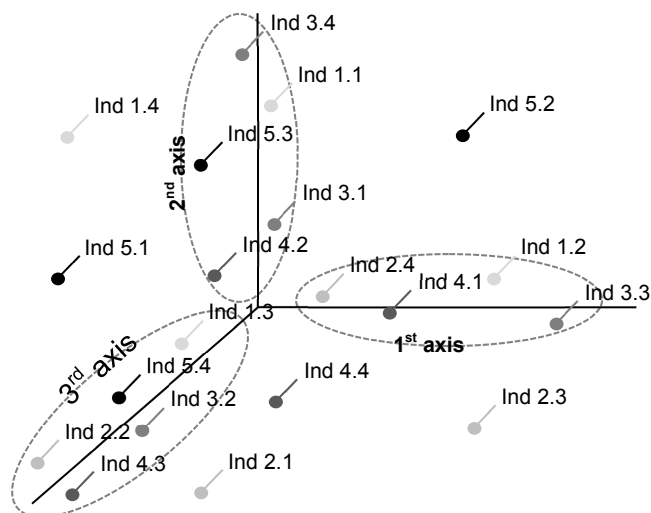
Unreliable variable (pointing to 'xxx' in Ind 1.3 for Month 3)

This table exemplifies the cleaning of the database, where one performance indicator contains several missing values and another one that have unreliable data (e.g. due to a change in the measurement or the re-definition of the variable). These kinds of indicators should either be corrected (if possible) or, otherwise, completely excluded from the final database.

As such, the PCA fits better this study requirement, as it is appropriate for a non-predefined experimental model, while factor analysis is righter for models that have already a standard. As the statistical technique applied (PCA) is handling historical data, the outcome of the actual research will subsequently be contingent on the data obtainable at the time of collection. Nevertheless, the purpose of this model is

not to build the best indicators, which sometimes could lead to subjectivity and personal preference, but to actually emphasize the significance of the variables available.

Figure 4: Filtering the Performance Measures per Strategic Perspectives



Above figure illustrates the three main achievements in performing this third step: 1) generate the number of strategic axes (example shows 3 perspectives), 2) filter and retain only the performance indicators that are highly correlated (illustrated by the circles seizing only the relevant variables) and 3) label the groups of indicators by analyzing the information that gravitates each strategic perspective (for the sake of clarity the perspective names have been kept as 1st, 2nd and 3rd axis).

The software applied for the PCA calculation was SPSS. In the presented example, when this step is conducted over the whole variables, one can clearly observe that with four components, approximately 93% of the total organizational variance is explained (Table 2). This percentage can be interpreted as the influence of the axes on the total performance: the higher this percentage, the more explanation it provides on the company’s performance.

Table 2: Extract of Total Variance Explained

Component	% of Variance	Cumulative %
1	24.26	50.53
2	11.97	75.46
3	5.78	87.51
4	2.76	93.26
5	1.37	96.12
6	0.80	97.79

This table shows the extract of the first six components cumulating a total of 97.8% of the organization’s variance. However, with only four components and a total variance explained of 93% it is assumed to be sufficient to extrapolate to the total variance of the company.

The same PCA technique also provides the influence of the variables (indicators) against each of these four axes with the assistance of the component matrix establishing the correlation of all variables with each of these axes. Table 3 illustrates the correlation of the first 10 variables with each axis. The nearer a correlation is to zero, the less the corresponding variable influences the axis. Finally, the variables will be ranked and filtered with respect to the correlation it has upon the axes.

The first 10-15 indicators per axis are favored for selection, ranked by their correlation with the axis. First, these metrics offers a good outlook on the information clustered and second, because the indicators are sorted by correlation, their explanatory value will decrease when moving further in the ordered list. One may note that this straightforward selection will congregate the performance measures that are particular to one area of the company. To be precise, a simple mathematical clustering will distinguish

the actual areas specific to the institution. The ranking and grouping of variables by axis will permit to label and define them strategically.

Table 3: Extract of the First 10 Indicators from Component Matrix

VAR no.	VAR name	1 st axis	2 nd axis	3 rd axis	4 th axis
VAR001	persofindetr	0.886	-0.259	0.324	-0.182
VAR002	persoju	0.765	-0.310	0.454	-0.257
VAR003	persoadmin	0.968	-0.153	0.092	-0.050
VAR004	arrivé	-0.021	-0.280	-0.098	-0.750
VAR005	départ	-0.192	0.134	-0.678	0.632
VAR006	agemoy	0.649	0.586	-0.109	0.288
VAR007	ho	0.902	-0.285	0.270	-0.073
VAR008	fe	0.799	-0.199	0.390	-0.348
VAR009	expeant	-0.221	0.273	-0.460	0.666
VAR010	formation	0.318	-0.521	0.567	-0.392

This table displays an extract of the first 10 performance indicators (out of the total 48 from the final database) with their respective correlation with each of the four components (or axis).

Statistically speaking, the top ranked indicators are highly correlated to the respective axis. However, after the PCA analysis, one still needs to do a rigorous analysis of the data and eliminate and/or replace those measures that would not adequately explain the definition of the perspective. While this procedure it is not mathematically validated, it is primarily aimed to clear out certain metrics that would violate the definition of the axis. The rejection or replacement of any indicator must be well justified in front of the strategy for defining the strategic axes. In any economic environment (which by definition is uncertain), it is improper to consider that all indicators correlated to the perspective in cause are also representative from a strategic viewpoint. Those indicators that do not describe the definition of the axis should not be selected in the final model as these might potentially corrupt the final result.

With the intention of better controlling and comprehending the final model and in order to maintain certain accuracy on the strategic perspectives, the final number of indicators per axis should rarely exceed 10. At the end of this third step, the organizational strategy from the presented example was acknowledged to gravitate along four perspectives: Regional Representation, Financial Perspective, Quality Perspective and International Law and Protection each of them containing 6 to 10 explanatory variables as described in the next step.

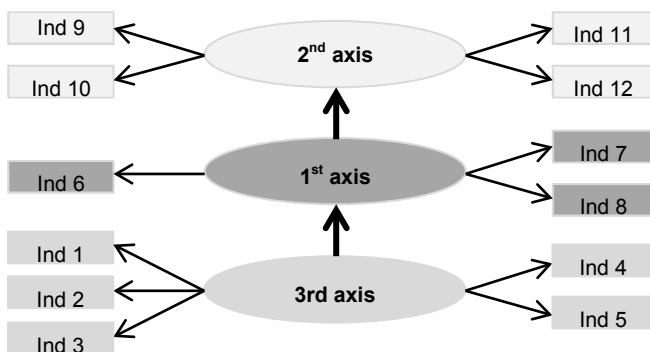
As exemplified in Figure 5, the *fourth major step* in ascertaining the actual strategy of the company is to employ a PLS Path Modeling regression on the final strategic perspectives. To determine the most viable cause-and-effect chain between the perspectives, all possible valid connections between these axes should be studied. The most stable PLS model from all possible combinations is regarded as the closed to the organization’s current strategy. The stability of the PLS model could be assessed applying a bootstrap technique on each possible graph.

Applying this step to the specific example of this study, all possible valid connections between the four axes, that is to say a total number of 52’720 possibilities were examined with the in-house created software and the most stable PLS graph was chosen from all valid combinations represented in Figure 6. This assembly is the optimal structure of connection between the four axes and turns out to be more realistic than any other model - the closest to the actual organizational strategy.

This assembly is the optimal structure of connection between the four axes and turns out to be more realistic than any other model - the closest to the actual organizational strategic vision. This representation shows that the angular stone of the strategy is characterized by the Regional Programs, which, in turn, influence the financial health of the organization. The financial perspective affects at the

same time the general quality of work as well as the whole of the “International Law & Protection” Program. In order to seize what these three bonds contain, we will study successively the causes suggested by the graph above. The objective is to briefly try to foresee what comes out from these causal connections.

Figure 5: Exemplification of a Cause-and-effect Chain Using PLS Path Modeling



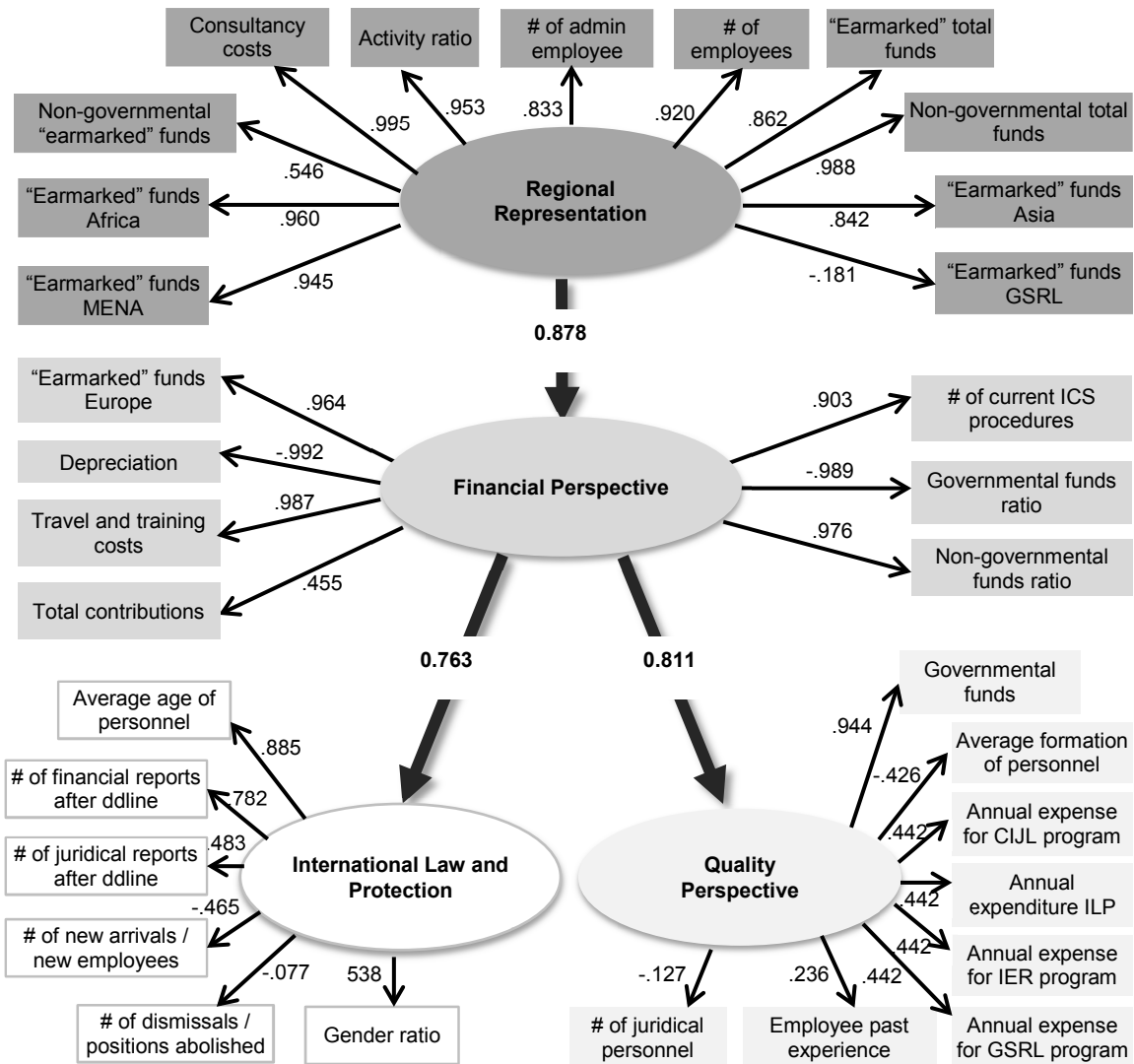
This figure illustrates 3 strategic perspectives together with their respective performance indicators linked in a cause-and-effect chain. The reason why the order of the axes is different is to show that after the bootstrap technique is finalized, the optimal model sequence might be altered.

The diagram emphasizes a capital element by spotlighting the Regional Programs. Indeed, we find among the variables which define this axis the nongovernmental funds under all its aspects: nongovernmental funds, nongovernmental restrictive funds (earmarked), total restrictive financing (earmarked), as well as the funds specifically intended for Asia, Africa and MENA. Consequently, we tend to believe that these programs are at the origin of the financial performance of the organization. In addition, since the causal links are one-way, activities of the regional programs can only be the subject of auto-financing and therefore the activities are not covered by any formed of organizational reserve.

Since the contributions for the Regional Programs are higher than the expenditure needed within the framework of their activities, it is perfectly obvious that are actually contributing to reserves of the organization. The reason why the Europe is attached to the Financial Perspective and not to the Regional Representation where one would see fit is that the principal activities as well as the headquarters are based in Geneva. This region is mainly seen as a support area rather than a “fundraiser” one.

Applying the logic further, the accumulated reserves can fund and support the International Program “ILP” as well as the Quality area. This is explained by the fact that the organization is characterized by a very high reputation and quality of the work. The education level of the personnel coupled with related expenditure is therefore essential. Contrary to the initial model of Kaplan and Norton (1992), the quality perspective does not influence the customer satisfaction, which, in fine, affects the financial area of the organization. This is indeed true as funds raised from various regional projects are not dependent on the overall outcomes of the organization. Or, in other words, the International Program “ILP” is financed in an organic way (bond between the financial health and the International Program), in order to provide a form of results which do not produce any “return on investment” (bond between the financial health and quality). This can be explained by two factors: 1) the quality of the work provided by the organization is already over and above the required standard and/or 2) the quality of the work is not important in the stakeholders’ eyes (contributors). Whatever the cause, this last conclusion needs further investigation from the management side, especially that the current strategy is considered as problematic. It should be also noted that any management tool is usually needed to be implemented in a period of transition and important changes within the organization.

Figure 6: BSC's Cause-and-effect Chain Using PLS Approach (with 12 Quarterly Periods)



Above illustration represents the optimal structure of connection between the four strategic perspective and turns out to be the closest to the actual strategy of the organization. This final assembly has been selected from all possible connections using the bootstrap technique, being the most stable PLS graph.

When it comes to model validation from a statistical point of view (Table 4), the overall figures are assessing appropriately both measurement (outer) and structural (inner) model. As a general rule of thumb, in order to validate the outer model (measurement model), the Average Variance Explained (AVE) should be above 0.5 (Chin, 1998) and Composite reliability greater than 0.6 (Werts, Linn, and Jöreskog, 1974). Although all figures are exceeding the required threshold, one should note the borderline for Quality Perspective. While this perspective is perfectly validated, the low value will demand for a closer investigation together with the business of the measures that are building this block.

As for structural (inner) model validation, the best gauge to use is the R-square level. Values of 0.67, 0.33 and 0.19 are considered to be strong, moderate and respectively weak for the inner model valuation (Chin, 1998). The R-square have acceptable values for ILP Program as well as for the Quality Perspective, even very close to the highest acceptance threshold. Furthermore, for the Financial

Perspective one can remark a strong significance, materializing the conclusion that all values are validating in a satisfactory way our model.

Table 4: PLS Model Validation Criteria

	AVE	Composite	R-square	Redundancy index
Regional Representation	0.728	0.939		
Financial Perspective	0.834	0.821	0.770	0.641
Intl. Law and Protection	0.656	0.844	0.582	0.464
Quality Perspective	0.540	0.785	0.656	0.333

The table is summarizing several validation criteria for the selected PLS graph. The AVE and Composite reliability are used for the measurement model validation (or the outer model, that is to say the relationships between the latent variables with its observed variables) and the R-Square and Redundancy index are employed to validate the structural model (or the inner model, thus the relations between the endogen and exogenous latent variables)

As stated in the beginning of this study, the inner and outer relations are based on structural equations. Hence, behind each PLS Path model lies equations that supports the relations between indicators and the corresponding axis (outer model equations) and between the axes or strategic perspectives themselves (inner model equations). The *fifth major step* is consequently based on applying these equations in order to study and forecast the relations for the long term. From a practical point of view, there are substantial advantages in doing that: a.) analyze the variance impact of one (or several) indicators to the whole model; b.) forecast the strategic changes by looking at the relationships between the axes; c.) visualize and manage both direct and indirect changes needed for an important change in the company’s strategy; d.) simulate the impact of resources allocation decisions on the future performance, thus complementing the traditional budget approach;

However, one should keep in mind that an organization takes time in order to recalibrate to any change or crisis situation. Any change in the company’s strategy should be done in a pondered and controlled way. Moreover, it should be noted that a non-profit organization cannot be revolutionized or radically transformed as a commercially-driven company might be.

DATA AND METHODOLOGY

The data has been collected with the help of the Corporate Strategy Head ensuring high quality and reliable data. A total of 54 performance indicators have been gathered throughout the organization summarizing their evolution over 3 years on a quarterly basis. The crucial part in the proposed methodology is the selection of the number of axes and of the corresponding performance indicators. It is essential that the key performance indicators describe to a certain extent the strategy of the organization. Unquestionably, the strategy metrics differ among organization, especially among different sectors (e.g. profit vs. non-profit).The first cleaning of the initial database was jointly done with the business owners and under the guidance of the Corporate Strategy Head. After this first sift, only 48 key performance indicators have been kept in the final database.

In order to find the number of strategic perspectives and to filter all performance indicators per each axis, the principal component analysis (PCA) has been applied over the final database using SPSS software. After the final selection and grouping of indicators, in-house software (PLS Assistant) has been applied for the PLS Path Modeling. The software is capable of assessing the most stable PLS graph by applying the bootstrap technique to each possible arrangement and connection between the latest variables (strategic perspectives in our case). Finally, the data has been validated using several measures widely employed in the PLS specialized literature: AVE and Composite Reliability for the outer model validation and R-Square and Redundancy Index for the inner model validation.

FINDINGS

The main objective of this study was to put in debate the Kaplan and Norton BSC theory compared to a more pragmatic approach. Having founded the strategic research framework, we attempted to empirically validate the proposed model by developing a strategic map in the context of a Swiss nonprofit organization. The results obtained indicated that the BSC problems can be formalized in a more rigorous way. It is thus possible to reassess the notions progressed by Kaplan and Norton as exposed in the analysis of this case. The application of PLS Path Modeling translates the actual strategy into a cause-and-effect model that can be monitored and controlled using a handful of essential performance indicators. One might debate that by treating historical data, the model summarizes obsolete information by illustrating a picture that cannot be utilized to influence the future planning. While this assumption is legitimate, the model is actually identifying the actual strategy applied by the organization. Only by fully acknowledgement of the current situation one can plan for the period to come. As suggested in this paper, as the PLS regression is more suited for maximizing prediction, the model is also capable of portraying the forecast strategy of the company. Furthermore, this approach allows the simulation of the resource allocation impact on the company's overall performance.

Lastly, it should be noted that these management tools are applied in a moment of a significant need for strategic change in the organization. The use of this approach allows not only understanding the chain of causality between different strategic areas of the company's performance, but also reinforces the intuition with “a measure of the measures”.

It should be stressed that the necessary conditions are relatively constraining. It is essential to have an adequate number of indicators together with a consistent historical sample of data. Furthermore, the noted real value of BSC lies more in the diffusion and the comprehension of the strategy on all the levels within the company. Thus, this requires strong communication, interpretation and analytical skills.

Whereas we aimed and struggled to have the highest objectivity in our methodology, both for data collection and data analysis, it might be that some variables have been biased by personal views. Indeed our approach can be impartially applied, however in practical terms we noticed that a level of flexibility should be taken into consideration, level that cannot be mathematically proven or admitted. The threshold depends on the organization culture and the people one is interfering with at the time of the analysis. The Partial Least Square (PLS) technique will likely grow in usage in the upcoming period, as it is considerably less difficult to understand than the covariance-based techniques when it comes to identifying a model and explaining of results. However, disadvantages of PLS contain greater complexity of explaining the loadings of the independent latent variables and since the distributional characteristics of estimates are not acknowledged, the researcher cannot assess model significance with the exception of bootstrap induction. In addition, being quite a novel statistical technique, there are few universally accepted thresholds for the model validity and stability up to now. Nevertheless, we have applied the small number of tools available for PLS Path Modeling approach, tools commonly utilized in other PLS studies found in the specialized literature.

Based on the findings from our study, further research may aim for a much higher degree of both complexity and dynamism. The more insights that are gained into the “mechanics” underlying performance, the more the individual models in framework proposed can be developed. It would be beneficial to apply our research framework to other industries or countries. The framework could be particularly useful for analysis of other industries such as media, telecommunications or high tech. More and more industries are characterized by a truly changing and challenging environment. It is time, to replace simple tools with a more realistic approach to analyzing performance in such environments. A comparison of the results of such an analysis with the findings of the present study could conduce to a higher validity and generalizability of the approach.

Another interesting path to follow would be to apply the structural equation in order to predict the future trend of the company, at time T+1, T+2 and so on and so forth. This will complete the analysis in a full and comprehensive framework that will present ways to improve the company performance. We are convinced that this will provide the manager with the optimal tool to assist him in piloting the organization. To conclude, we believe that it is relevant to develop a more formal methodology in order to validate the company's strategy in a rational way, while using a simplified model. Indeed the PLS method suffers from a deficiency of theoretical foundation. Similarly, Kaplan and Norton's approach was strongly criticized in the specialized literature from this point of view as well. The difficulty with which future researchers will be challenged lies in the compromise between the pragmatism sought by the organizations and the need for the theoretical framework required by scholars.

CONCLUDING COMMENTS

The research aim of this paper was to elaborate and empirically validate an inclusive framework that channels Balanced Scorecard model with Structural Equation Modeling approach and endorses a modern comprehension of factors underlying the current strategy, in order to better manage and control the corporate performance.

The essential step towards this goal was the development of a general frame of reference that harmonized previously conflicting theoretical assumptions related to Balanced Scorecard as well as its ease of implementation. On this basis, the proposed framework is embracing several major concepts: 1.) addresses the issues of strategic vision of any organization and translates the actual strategy into an easy-to-use model for better integration, communication and long-term management; 2.) underlines the key performance indicators that have the ability to seize the most relevant information from the company, information that is strongly connected to the current objectives the organization is aiming for; 3.) compiles distinctive strategic perspectives that summarizes company information in a suitable way, in order to create a comprehensive illustration driving organizations in their road to success; 4.) determines the relationships between strategic perspectives in a cause-and-effect chain that highlights the interactions taking place at a strategic level, helping in spotlighting the company's advantages and weaknesses; 5.) overcomes the static feature of previous models revealing the dynamic evolution over time by employing mathematical PLS equations, refining the planning and control of the main constituents within an organization.

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ESTABLISHING STRATEGIC SALES ORGANIZATIONS IN EMERGING MARKETS: THE CASE OF SAUDI ARABIA

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ABSTRACT

This paper focuses on examining the sales force transformation process through the sales-marketing interface theory using Saudi Arabia as a case study. The study's results show context-specific challenges posed by organizational hierarchy, roles and responsibilities of sales and marketing personnel, and managerial competencies to this process. We suggest that since firms in emerging markets may lack well-developed marketing and sales apparatuses, the transformation process may turn into a two-step process that requires changing sales and marketing's roles and responsibilities.

JEL: M16, M31

KEYWORDS: Sales, Transformation, Saudi Arabia, Interface

INTRODUCTION

The recent advances in the sales literature suggest that firms must transform their sales organizations from simply being the implementers of tactical marketing activities to playing a more strategic role (Piercy 2006). Since sales organizations act in conjunction with marketing in creating and delivering customer value, it is plausible that marketers may play a crucial role in the process of sales force transformation. A majority of extant research on sales-marketing interface, however, highlights the presence of less than optimal interface dynamics within firms (Kotler, Rackham, and Krishnaswamy 2006; Montgomery and Webster 1997). Thus, while the idea of transforming sales organization to make it more strategic may seem appealing; given the acrimonious relationship between sales and marketing, firms may run into many challenges as they begin to transform their sales organizations to be more strategic.

A majority of extant research in the sales and interface domains has been conducted in developed economies such as the US, EU, and Australia/New Zealand. Specifically, using western research contexts, scholars have brought forward the various roles sales organizations play within firms and the differences in orientation, job profiles, and sub-cultures that can cause a rift within the interface (e.g., Dewsnap and Jobber 2000). Similarly, Malshe (2009) has identified the role and process-related factors that may impact the process of sales transformation in western context. Given that Burgess and Steenkamp (2006) note that emerging economies may serve as research contexts that can challenge the basic tenets of prevalent marketing theories; it is plausible that if sales force transformation process were examined through the sales-marketing interface lens in an emerging economy, we could gain greater theoretical insights into the context-dependent challenges to this phenomenon that may expand the bounds of interface theory as well.

On this backdrop, we examine the following research question using data collected in Saudi Arabia: How do (a) sales and marketing's roles and scope of activities, and (b) environmental variables, unique to the emerging Saudi market context, affect the sales transformation process?

The balance of this paper is organized as follows. The literature review and background is presented in the next section. This is followed by a summary of the data collected, method used and the presentation

and discussion of the results found. Theoretical contributions, managerial implications, and direction for future research were discussed next. A conclusion of the study is presented in the last section.

LITERATURE REVIEW AND BACKGROUND

We offer a brief overview of three theoretical domains that our work draws upon- interface, strategic sales organizations, and Saudi Arabian business context.

Research on sales-marketing interface has identified factors that may challenge or facilitate its smooth functioning such as interface integration, collaboration, and communication (e.g., Beverland, Steele, and Dapiran 2006; Oliva 2006). Scholars have also examined how different interface configurations affect strategic outcomes, how sales and marketing may work closely in building marketing strategies, as well as what marketers may do to get a buy-in of their strategies from the sales force. (Biemans, Makovec-Brenčič, and Malshe 2009; Malshe and Sohi 2009).

Piercy (2006) argues that today's competitive business environments require that salespeople are deeply integrated into firm's strategy-making process. This may be achieved through focusing on the following five "I"s: (a) *Involving* sales organization in marketing strategy debates; (b) Treating customer *intelligence* as a strategic decision-making resource; (c) *Integrating* sales and marketing functions to create and deliver superior value propositions; (d) Utilizing sales input to *internally "sell"* customers; and (e) Developing *infrastructure* that allows sales and marketing to maintain competitive advantage in the market.

Saudi Arabia, an emerging market, has a unique societal and business culture influenced by Islamic values. This culture exhibits characteristics such as high power distance and high uncertainty avoidance, and may cause people to respect organizational hierarchy, and favor compliance and consensus building over conflicts (Hofstede 1980). Further, Saudi organizations employ a system of traditional authority, emphasize adherence to norms and common values, and value organizational goals as much as individual goals thereby affecting the intra-organizational dynamics (Al-Habib 1995; Bhuian 1998).

Thus, if we examined the sales force transformation process through the interface lens within an emerging market context, it is likely to bring forth the hitherto unexplored challenges thereby expanding the theoretical boundaries of sales and interface literatures.

METHODOLOGY

We view our research as a discovery-oriented exploration (Deshpande, 1983). Accordingly, we used qualitative methodology. Specifically, using theoretical sampling technique (Strauss and Corbin, 1998), we interviewed 39 informants from sales (17) and marketing (22) departments from a wide range of companies in healthcare, IT, engineering, financial services, and consumer products industries in Saudi Arabia during the first half of 2010. Our informants represented all levels within the sales and marketing hierarchy. Informant firms' revenue ranged from US\$10-\$65 million and all firms within our sample had distinct sales and marketing functions. Table 1 shows the informants' demographic profile.

Our discovery-oriented interviews lasted between 40 to 70 minutes and focused on exploring the strategy-making processes within Saudi firms. We used a pre-tested interview protocol and conducted all interviews in English. We allowed our informants to guide the discussion and minimized interviewer-induced bias in our conversation (McCracken, 1988). We stopped interviews upon reaching theoretical saturation. We transcribed all interviews, and managed and analyzed our data using NVivo. We used a systematic coding process that consisted of open coding followed by axial coding (Corley and Gioia,

2004). Our axial codes helped us deduce the major themes that brought forth the key insights we present in our findings.

Table 1: Informants' Profile

Function:		Industry Type:	
Marketing	56%	Service	26%
Sales	44%	Manufacturing	56%
		Trade	18%
Gender:		Education:	
Male	77%	Undergraduate degree	59%
Female	23%	Graduate degree	41%
Organizational Level:		Work Experience:	
Junior Level	18%	2.5–5 years	33%
Middle Level	38%	Over 5 years	67%
Senior Level	44%		
Existence of Department:		Firms' Revenue Range	US\$10-\$65 million
Marketing	100%		
Sales	100%		

This table shows a summary statistics of the demographic data collected from the 39 informants.

We insured analytical rigor (Lincoln and Guba, 1985) by asking two independent judges to evaluate the coding of 21 randomly selected interviews, and our data interpretations. We also used member checks (Creswell, 2007) to vet our data interpretations.

RESULTS

Our findings suggest that sales-marketing interface in Saudi firms exhibits unique characteristics. Specifically, while marketing exists as a department, marketers do not possess any strategy-making authority. They simply follow their leaders' strategic plans and are tasked with giving salespeople specific directives about strategy implementation. Sales organizations, on the other hand, are viewed purely as an implementation channel and it is an explicit expectation in Saudi context that salespeople would oblige with marketing's directives. Our analysis further suggests that given the status quo within Saudi interfaces, if they were to embark on the process of transforming their sales force, they might encounter the hitherto unstudied challenges on each of the five mechanisms (Piercy 2006). We discuss these challenges below.

The first mechanism to transform sales organization (Piercy 2006) is that of involving salespeople in strategic discussions. This principle pre-supposes that the strategy-making power lies in the hands of marketing department, who then must engage salespeople in strategic discussion. As noted earlier, in a majority of Saudi firms marketers do not possess strategy-making power. Further, they view salespeople purely as an implementation tool. Thus, Saudi firms do not possess the necessary pre-requisites to even begin exploring the notion of salespeople's *involvement*. As a result, the process of involving sales force faces a two-step challenge and is mediated through marketing assuming the strategy-making responsibility.

Lacking sophisticated marketing research infrastructure, Saudi salespeople collect only rudimentary customer data on an ongoing basis. Further, since they mostly focus on executing day-to-day tasks; they do not develop sophisticated skills to capture customer intelligence that can then be utilized in strategy formulation. In addition, Saudi marketers, lacking any strategy-making power are not in a position to guide the sales force about what type of customer intelligence they may collect. Overall, the confluence of these factors poses a deep challenge to the outside-in flow of information within Saudi firms thereby hampering the processes of intelligence gathering, organizational learning, and knowledge management.

Our data bring forth the fact that the notions of respecting organizational hierarchy and maintaining differential status based on one's position are deeply entrenched within Saudi firms. As a result, marketers, being closer to the top management, are perceived by the sales force to be holding a higher status within the organizational hierarchy. Further, many times, it is an explicit expectation within the organizations that sales departments will comply with directives given by their marketing counterparts. Hence, we argue that such deeply entrenched status differences may give rise to integration challenge and prevent sales and marketing organizations from (a) viewing themselves as partners, and (b) forging deep cross-functional relationships.

In firms with optimal internal marketing processes, salespeople are able to "sell" customer pain-points internally and elicit optimal strategic response. Our analysis suggests that Saudi context poses three major challenges in this regard. First, the top management decides on the firm's strategic priorities and does not invite or value sales input prior to developing strategies. Second, firms do not possess appropriate mechanisms to channelize even the rudimentary market information collected by salespeople to the appropriate target audience within the firm. Third, given the hierarchical nature of Saudi firms and the status differential observed among sales, marketing, and top management; sales input is usually not given high credence. Overall, our analysis suggests that the contextual variables collectively create many impediments that hamper the process of internally marketing the customer pain-points within the firm.

Piercy (2006) argues that creating optimal infrastructure may facilitate the process of strategic sales transformation. We argue that the development of appropriate infrastructure is contingent upon the fact that both sales and marketing personnel have engaged in strategy discussions earlier, identified the limitations of their existing infrastructure to serve the changing market needs, and have come up with concrete ideas about building superior infrastructure. As noted earlier, since sales and marketing personnel in Saudi firms do not (a) possess any strategy-making power, and (b) engage in strategic discussions; it is plausible that they may have limited ideas regarding the improved infrastructure needs. This may inhibit organizations from making any concrete efforts in developing specific infrastructure.

THEORETICAL CONTRIBUTIONS, MANAGERIAL IMPLICATIONS, AND FUTURE RESEARCH

This paper makes four contributions. First, we test the idea of sales force transformation through the lens of interface theory in an emerging market context. In doing so, we unify perspectives from interface theory and strategic sales literature, and bring forth how the challenges sales force transformation may encounter within an emerging market context are markedly different from those Malshe (2009) has reported in the US context. Second, our empirical findings highlight how variables such as organizational hierarchy, status differential between sales and marketing, roles and responsibilities of sales and marketing personnel, and managerial competencies, among other factors, can pose challenges to the process of sales force transformation (Piercy 2006). Extant research has not explored this area in detail. Third, our findings bring forth the fact that when organizations possess ill-defined marketing and sales apparatuses, the process of sales force transformation is a two-step, long-term process that must begin with empowerment of sales and marketing with specific responsibilities. Once this is achieved, firms can then device processes to implement ideas Piercy (2006) suggests. As such, the process of sales force transformation in the Saudi context is mediated through the transformation of marketing. Last, our research responds to the call from Burgess and Steenkamp (2006) and initiates the process of testing the limits of strategic sales and interface theories in an emerging market context.

Our findings urge managers that before they embark upon the process of sales force transformation, they must assess where their sales and marketing apparatus is at in terms of their roles, responsibilities, and strategic authority. This will help them plan their resources as well as set realistic expectations for the transformation process. Next, our findings bring forth the myriad challenges involved in sales force

transformation, the knowledge of which will be useful for managers in emerging economies as they think through the transformation strategies. We treat this research as the first step in understanding the phenomenon of sales force transformation. Future research may use other emerging markets as research contexts as well as different methodologies to understand this area further.

CONCLUSION

The transformation of sales organizations from being implementers of action marketing plans to playing a more active strategic role have been examined in developed countries. However, using Saudi Arabia as a case study we could gain greater theoretical insights into the context-dependent challenges to this phenomenon. In this study, we explore how sales and marketing's roles and variables unique to the emerging Saudi market context, affect the sales transformation process. Data were collected using discovery-oriented interviews of sales and marketing informants to explore the strategy-making processes within Saudi firms. The transcribed interviews were managed and analyzed using NVivoes. The findings suggest that sales-marketing interface dynamics within Saudi context are unique. Despite the existence of marketing departments in the surveyed firms, marketers do not play a strategic role. Their role is mostly limited to executing their firms' strategic plans and giving salespeople specific directives about strategy implementation; salespeople would be pleased with the marketers' directives. It is suggested that Saudi firms willing to enter into the process of transforming their sales force might encounter some challenges in terms of their involvement, intelligence, integration, internal marketing, and infrastructure. We suggest that since marketing and sales functions are generally not well developed in emerging market firms, the process of sales force transformation is a two-step, long-term process that must begin with empowerment of sales and marketing with specific responsibilities. Firms can then device processes to overcome the challenges faced during the process of transformation. This study was exploratory in nature, and despite the small number of informants, theoretical saturation was reached. More research in other emerging markets is needed as well as different research design and methodologies to understand the process of sales force transformation.

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A CRITICAL NEEDS PLAN FOR GENERAL MOTORS: A CULTURAL PLURALISM APPROACH

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ABSTRACT

The purpose of this paper is to create a critical needs plan for General Motors Corporation in the 21st century. General Motors (GM), once the most dominant manufacturer in the automotive industry, finds itself in financial crisis with a Chapter 11 bankruptcy and a necessary government infusion of capital. The foundation of this paper applies the Supportive Model as an effective strategy for creating a new corporate culture and focusing GM as a competitive manufacturer in the global automotive industry. The basis of this critical needs plan focuses on more than managerial or financial influence, but a cultural change including corporate ethics, corporate social responsibility and a critical thought approach to operating in the 21st century.

JEL: M1

KEYWORDS: Leadership, Cultural Pluralism, Organizational Behavior

INTRODUCTION

With the increase in global competitive pressure, it is important for a business organization to understand the organizational behavior and dynamic changes to its cultural and ethical environment. Economic globalization has forced many U.S. companies to take a hard look at their competitive environments focusing on the steps necessary to remain competitive on the world-stage. Engle (2006) observed that many of the top industrial powerhouses within the past 10 years have realized that past success does not equate to future gains. Companies must replace complacency with an intense effort to optimize operational processes by examining the organizational behavioral. This is especially true for companies facing critical issues. This case study provides a critical needs plan for General Motors Corporation. The organization's culture and ethical behavior are two of the many possible subject areas examined as an overall plan to optimize operations. The recommendations will take a comprehensive approach by considering leadership, organizational culture, financial ramifications, cross-cultural issues, and potential ethical conflicts.

A critical needs plan for a global company such as General Motors Corporation includes an assessment of global culture and global ethics. The structure of the organizational plan for General Motors is to be adaptive to the global environment and strategically support global markets competitive demands. According to Hannan and Freeman (1977), any plan focusing on a global company is complex and relies on a working strategy that supports a relationship between the structure and its environment. Gupta and Govindarajin (2004) believed that globalizing in today's business environment necessitates organizations recognize four key constructs to globalizing in the 21st century: (a) the organization's position in the market; (b) the availability of capital to expand the organization; (c) the availability of supplies for the organization and (d) a corporate outlook that considers the overall global picture.

The paper will present an exploration of General Motors' proposed critical needs plan in four specific areas. First, cultural behavior will examine the importance of cross-cultural diversity for a global corporation, as viewed through the application of a supportive leadership model. Second, ethics and

leadership as it relates to responsibility to internal and external stakeholders will be evaluated in conjunction with the transformational leadership model. Third, corporate social responsibility will be evaluated by comparing market mentality versus social responsibility mentality, including an application of utilitarianism ethical theory. Last, several management approach issues will be considered, including a SWOT analysis, the critical thinking approach to decision making, and the importance of partnerships and alliances in the contemporary global marketplace.

REVIEW OF THE LITERATURE

Jung and Avolio (1999) believe that successful organizations that expand globally understand the differences in foreign cultures and that this understanding corresponds with the exponential growth of the global economy. With the diversity of cross-cultural differences, it is critical that General Motors study each market's cultural organizational behavior and determine if a common matrix exists.

The Supportive Model is an effective model for use as a base plan for any organization's needs. This model illustrates leadership by a human resources approach of emphasizing support for the workers as the most important factor in leading the organization. According to Newstrom and Davis (2002), leadership and not managerial authority is the foundation of the Supportive Model. This type of leadership helps promote employees' growth and motivates them to obtain common goals that are beneficial to the organization.

Cultural pluralism defines the manner in which an organization reacts to the changing cultural paradigms. Successful organizations find ways to adapt to the changes in beneficial ways while continuing the involvement and advancement of its internal members (Nagar, 2005).

General Motors did not experience success until 1923 with the hiring of Alfred P. Sloan as Chief Executive Officer. Sloan changed GM's corporate philosophy by concentrating each GM brand to a dedicated market resulting in overall U.S. market domination that rose as high as 50% between 1950 and 1965. In addition to being the largest automaker, GM prided itself on producing automobiles at the lowest cost while remaining the style leader of the industry (Olson & Thjomoe, 2010). The domination was so prevailing that in 1955 the United States Congress began anti-trust hearings threatening to divide the company into smaller segments. Although no action was taken, GM management realized that a refocus of corporate direction was necessary. Instead of increasing its market share, GM would need to find ways to increase its profit margin while maintaining its existing control of the market (Olson & Thjomoe, 2010).

By 2009, General Motors had declared bankruptcy and was in the process of eliminating certain brands and closing dealerships and operations (e.g. Saab, Hummer and Pontiac). Furthermore, the company required an immediate cash infusion of \$50 billion in capital from the U.S. Government in order to meet current daily obligations. The price for the involvement of government money was to force the accelerated sale of GM assets (Lubben, 2009).

Key to regaining consumer confidence begins with a change in an organization's culture. According to Harbour-Felax, General Motors is aware of the issues related to its financial downfall, but failed to make the necessary cultural changes to resolve these issues (Zoia, 2006). General Motors needs to embrace diversity in global manufacturing facilities and market share. The changing global environment, increased fuel costs and a desire for environmental protection creates a different culture that is necessary for success in the 21st century (Svensson, 2004).

Ethics and leadership are synonymous terms that work in conjunction with one another in order to establish a foundation in which an organization operates. Baron (2006) believed that ethical behavior is a

methodical approach to making decisions based on defined principles. In contrast, Bass (1990) believed that transformational leaders help to broaden the vision of one's followers focusing on creating an atmosphere that considers more than individual needs but considers the needs of the organization.

Wood (1991) defined corporation social performance as, "a business organization's configuration of principles of social responsibility, process of social responsiveness, and policies, programs and observable outcomes as they relate to the firm's societal relationships" (p. 759). General Motors acknowledges this responsibility by analyzing all legitimate parties to its operations in order to determine the potential conflicts between corporate responsibility and its social responsibility (Johnson, 1986).

In conjunction with the significant health care liability, the antiquated distribution system that adds at least 20 percent to the price of every new car enhances the overall problems at General Motors (Levinson, 2006). Kubasek, Brennan and Browne (2003) suggests that a critical thinking approach could help General Motors identify the company's strengths, weaknesses, threats and opportunities and will improve General Motors overall operations.

CULTURAL BEHAVIOR

Cultural behavior can vary significantly among different markets. Jung and Avolio (1999) believe that successful organizations that expand globally understand the differences in foreign cultures and that this understanding corresponds with the exponential growth of the global economy. Being the world's biggest automotive manufacturer prior to 2008, General Motors employed approximately 325,000 employees worldwide (Webster, 2006). With the diversity of cross-cultural differences, it is critical that General Motors study each market's cultural organizational behavior and determine if a common matrix exists.

The Supportive Model is an effective model for use as a base plan for any organization's needs. This model illustrates leadership by a human resources approach of emphasizing support for the workers as the most important factor in leading the organization. "[Elton Mayo and F.J. Rothlisberger] concluded that an organization is a social system and the worker is indeed the most important element in it" (Newstrom & Davis, 2002, p. 36). When dealing with a sensitive issue such as health-care costs and the expansion of operations into a foreign environment, it is important to implement a plan that demonstrates the company's commitment to its employees and those from the new foreign environment. A change in the organizational culture would not prevail over the individual priorities of a company's employees or the foreign environment. According to Newstrom and Davis (2002), leadership and not managerial authority is the foundation of the Supportive Model. This type of leadership helps promote employees' growth and motivates them to obtain common goals that are beneficial to the organization.

Utilizing the Supportive Model, General Motors can embrace cultural diversity and pluralism as part of the globalization strategy. Cultural pluralism defines the manner in which an organization reacts to the changing cultural paradigms. Successful organizations find ways to adapt to the changes in beneficial ways while continuing the involvement and advancement of its internal members (Nagar, 2005). One problem an organization finds when globalizing concerns that significant differences exist in the market's organizational culture. Cultural discomfort among management dealing with markets that they are not familiar with could result in disruption to business flow. The intent is not to force a change in the organizational culture, but embrace it and bridge different cultures together. The challenge of managing organizational culture is the human relation factors. Despite the fact that the company is from the United States, it would not be appropriate for General Motors to assume that foreign markets share a common vision. The key to dealing with organizational cultural differences begins with the identification of any commonalities among the different cultures. The goal is to develop a general plan encompassing components from existing cultures in order to establish a new global organizational culture.

Although incorporated in 1908, General Motors did not experience success until 1923 with the hiring of Alfred P. Sloan as Chief Executive Officer. Sloan, an engineer by trade, believed that product development began with design and must focus on the wants of the buying public. Sloan found that in the early years, GM's problems originated with its lack of brand specialization. Prior to Sloan's employment, the company failed to focus a dedicated brand to a specific market segment. Sloan changed GM's corporate philosophy by concentrating each GM brand to a dedicated market resulting in overall U.S. market domination that rose as high as 50% between 1950 and 1965. In addition to being the largest automaker, GM prided itself on producing automobiles at the lowest cost while remaining the style leader of the industry (Olson & Thjomoe, 2010).

The domination was so prevailing that in 1955 the United States Congress began anti-trust hearings threatening to divide the company into smaller segments. Although no action was taken, GM management realized that a refocus of corporate direction was necessary. Instead of increasing its market share, GM would need to find ways to increase its profit margin while maintaining its existing control of the market (Olson & Thjomoe, 2010).

Unfortunately, the decision to change business strategy failed to recognize the materialization of a new desired market segment for smaller more compact vehicles. Another issue confronting GM originated with the focus on reducing costs and increasing profits. The increase in profits did not go unnoticed by the United Auto Workers (UAW). The UAW was astute to the direction of the American automobile industry and that higher profits provided increased opportunity for union worker wages and benefits without an equivalent proportion of increased worker productivity (Martin & Schrum, 2010). A *New York Times* article in 2009 reported that upwards of \$ 1,000 per auto sold represented health care and pension costs to the company (Martin & Schrum). The issue is magnified when retirees are factored into the equation as upwards of 450,000 non-working individuals, retirees and surviving spouses, were covered by GM benefit plans in 2005.

In addition to the issues related to its benefit and pension issues, GM continued to further distance itself from its successful past by implementing a strategy of "platform sharing across GM division brands" (Olson & Thjomoe, 2010, p. 105). The strategy to cut costs included a reduction in Sloan's original plan of brand specialization sharing similar designs across the GM brand spectrum. Although the strategy did succeed in reducing overall costs, the long-term affect was a dilution of each brand's uniqueness. In 1979, GM's share of the U.S. market was 46%, but because of rising health care and pension costs, a reduction in worker productivity and a dilution of brand specialization that market share dropped to 22.5% (Olson & Thjomoe, 2010). By 2009, General Motors had declared bankruptcy and was in the process of eliminating certain brands and closing dealerships and operations (e.g. Saab, Hummer and Pontiac). Furthermore, the company required an immediate cash infusion of \$ 50 billion in capital from the U.S. Government in order to meet current daily obligations. The price for the involvement of government money was to force the accelerated sale of GM assets (Lubben, 2009).

The sale of the assets also created a way to reduce existing health and pension costs by creating a specialized trust called a Voluntary Employee Benefit Association (VEBA). The VEBA would be a fully funded separate entity that would guarantee benefits but required a promise of no union action (e.g. strikes) for several years (Lubben, 2009). The challenge created by the bankruptcy and government involvement is for General Motors to recreate the confidence it once experienced by consumers. Key to regaining consumer confidence begins with a change in an organization's culture. According to Harbour-Felax, General Motors is aware of the issues related to its financial downfall, but failed to make the necessary cultural changes to resolve these issues (Zoia, 2006). General Motors needs to embrace diversity in global manufacturing facilities and market share. General Motors needs to return to an organizational culture that embraces product specialization that focuses on the specific wants of its

consumer base. The changing global environment, increased fuel costs and a desire for environmental protection creates a different culture that is necessary for success in the 21st century (Svensson, 2004).

ETHICS AND LEADERSHIP

Elmer W. Johnson (1986), a former Vice President of Public Affairs and General Counsel for General Motors said:

The people of the United States and other industrialized nations of the free world, through their governments, have rightly come to look upon GM and other large corporations not simply as business enterprises organized for profit, but also as institutions with far-reaching responsibilities to protect and enhance various social interests and goals (p. 174).

Ethics and leadership are synonymous terms that work in conjunction with one another in order to establish a foundation in which an organization operates. Baron (2006) believed that ethical behavior is a methodical approach to making decisions based on defined principles.

General Motors recognized that its overwhelming position in both the U.S. economy as well as the global economy places the company in a unique position of more than a corporate giant. General Motors' actions affect more than just its internal stakeholders (e.g., employees, management, and shareholders), but has a direct affect on its nonmarket environment as well. "The nonmarket environment is composed of the social, political, and legal arrangements that structure interactions outside of, but in conjunction with, markets and contracts" (Baron, 2006, p. 2). Included in Baron's (2006) definition of the nonmarket environment are outside groups, governmental entities and the public. In contrast, Bass (1990) believed that transformational leaders help to broaden the vision of one's followers focusing on creating an atmosphere that considers more than individual needs but considers the needs of the organization.

Managing a business or organization requires careful consideration and balance of the various components. True leadership is capable of considering a multitude of components that includes both market and nonmarket issues. The concept of ethics is one of a guiding light or force to assist the leader in his or her quest to maximize the potential of the organization. The theory of transformational leadership works in conjunction with the plan utilizing the Supportive Model by considering the needs and desires of the General Motor's employees and its new partners in an ever-expanding global environment.

CORPORATE SOCIAL RESPONSIBILITY

General Motors recognized its inherent responsibility in its social performance as well as its corporate performance. Wood (1991) defined corporation social performance as, "a business organization's configuration of principles of social responsibility, process of social responsiveness, and policies, programs and observable outcomes as they relate to the firm's societal relationships" (p. 759). General Motors' social responsibility encompasses a wide range of stakeholders including employees, stockholders, customers, governmental agencies, and the public. General Motors acknowledges this responsibility by analyzing all legitimate parties to its operations in order to determine the potential conflicts between corporate responsibility and its social responsibility (Johnson, 1986). In the 1980s, General Motors experienced a conflict between these different responsibilities because of its former policy of "command-and-control" (Johnson, 1986, p. 174) to one of social responsibility. General Motors' attempt to implement a new mentality upon its management in a short period placed its managers in a quandary between a market mentality and a social responsible mentality required of corporate partners' intent on a comprehensive plan for interaction and responsibility within its environment.

As a subcomponent of the Supportive Model, the ethical leadership plan incorporates the theory of utilitarianism into the overall plan. “Utilitarianism is a consequentialist system with two particular features. First, consequences are to be evaluated in terms of the preferences of individuals, and second, those preferences are to be aggregated” (Baron, 2006, p. 702). Those following utilitarianism base their ethical decisions on the interest of the whole and not any individual part of the group. Utilitarianism finds its foundation in the needs of the General Motors employees in addition to the needs of its corporate environment. Within the Supportive Model, the theory of utilitarianism provides the General Motors’ management a clear overview of all possible directions in regards to health care coverage and how it will approach its plan that effectively globalizes the company resulting in reduced costs, increased profits, and an effective relationship with its hosts in various foreign countries.

MANAGEMENT APPROACH TO ISSUES

Rising health-care costs and a declining market share have significantly affected the financial stability of General Motors. General Motors is the largest private provider of health care within the United States. In conjunction with the significant health care liability, the antiquated distribution system that adds at least 20 percent to the price of every new car enhances the overall problems at General Motors (Levinson, 2006). Kubasek, Brennan and Browne (2003) suggests that a critical thinking approach could help General Motors identify the company’s strengths, weaknesses, threats and opportunities and will improve General Motors overall operations. The critical thinking approach encompasses the following eight steps: Step 1) the company must know the facts. In a global environment, it is important to be aware of consumer concerns and competitors position. The Supportive Model will enable General Motors to take a more proactive approach at focusing on gathering appropriate data necessary for future decisions. Step 2) the company must identify the critical needs and issues affecting the company. The primary questions or issues requiring attention are: (a) which factors contribute to General Motors excessive costs and (b) what are the contributing factors in decline in sales? The problem that all automotive manufacturers face is the rising costs of manufacturing when the emerging markets have limited resources for the purchase of automobiles and prefer a basic vehicle in comparison to the loaded varieties commonly found in the United States (Howell & Hsu, 2002). The answer lies in the creation of partnerships and alliances among competitors and technology companies.

Technological alliances permit General Motors a strategic advantage by establishing a relationship with a competitor with a sound base in a specific foreign market while utilizing common technology for the benefit of both companies. For example, a General Motors alliance with Suzuki opened an opportunity within the Asian market without the barrier of a new start-up operation. In conjunction with Suzuki’s presence in Asia, this alliance provides General Motors with,

... access to Suzuki’s small car platform and its low-cost manufacturing experience. The tie-up gives Suzuki access to General Motors advanced technologies, particularly alternative propulsion and hybrid systems, entry to the growing Latin American market and worldwide component sourcing (Howell & Hsu, 2002, p. 45).

The relationship between General Motors and Suzuki provides a focus of the critical needs plan for General Motors utilizing the Supportive Model. General Motors can no longer operate in the same manner it did during the 20th century. The future of General Motors depends on strategic alliances like the one with Suzuki. This provides a unique approach to supporting its employee base, stakeholders, and its new global alliances in an ever-expanding global environment. Step 3) the company must establish a set of logical reasons or justifications for supporting the business decisions. Management from the top and continuing down the chain of command should review all reasons and provide justifications for why these issues and risks were not identified sooner. The process of critical thinking requires that the

decision be viewed from a different set of lenses. "... Officers and directors are required to exercise their duties in a manner they reasonably believe to be in the best interests of the corporation" (Kubasek et al., 2003, p. 433). Critical thinking skills are important for business decisions to comply with emergent law and as well support of the community ethics (Kubasek et al., 2003). Step 4) once the appropriate facts are defined, the company must assess the legal and social impact of business decisions. This step is critical to General Motors' success in an ever-expanding global environment. The key is a comprehensive knowledge of the legal environment in the various foreign countries that General Motors chooses to compete. Step 5) once determined, the plan should be implemented at all levels of the business. It is important not to discard subjective reasoning without applying critical reasoning. Innovative ideas require an accurate utilization of critical thinking ability to determine if the information is factual or subjective with merit. This is critical when it comes to technical discussions, where ambiguous subjective comments such as *it can never be done* may have a negative impact on innovation. Step 6) in conjunction with plan review and implementation, the ethical norms of the business decision should also be considered. The primary ethical norms that provide direction of the legal environment of business are freedom, security, justice, and efficiency (Kubasek et al., 2003). The final decisions made by General Motors consider the ethical impact of its business decisions. What will internal and external stakeholders' think of the decision? Step 7) business decisions depend on the experience and knowledge of previous events. In order for General Motors to move ahead, the company must review and analyze previous events and actions. Step 8) the final step of the critical thinking process is to consider the business decision in regards to missing information. In a global environment, the dynamics of said environment change quickly and it is critical for the company to be on the cutting edge of all available information.

SUMMARY

This case study provided a critical needs plan for General Motors Corporation. The organization's culture and ethical behavior were two of the many possible subject areas examined as an overall plan to optimize operations. The recommendations took a comprehensive approach by considering leadership, organizational culture, financial ramifications, cross-cultural issues, and potential ethical conflicts.

The foundation of this critical needs plan for General Motors centers on the Supportive Model utilizing a critical thinking approach to globalization. Global expansion is inevitable for all automobile manufacturing companies. After many years of negative financial results and stratospheric increases in health-care costs, General Motors is taking a proactive approach in order to lower its manufacturing costs and expanding its market base into markets that are exponentially growing in the 21st century.

The Suzuki example in Asia demonstrates that implementing the Supportive Model focuses on the strengths of both partners considering the needs and desires of both the internal and external stakeholders. "Globally integrated strategies demand it to manage both the uncertainties involved in a highly intricate networking operation and to develop and implement strategies quickly to parry and riposte the actions of other companies pursuing a similar strategy" (Lei & Slater, 1990, p 29). The first automobile manufacturing company to maximize the advantages of a global market including those of reduced costs will set itself up as the primary manufacturing company in the 21st century. This case study reviewed the history of General Motors and its relationship to the changing of its culture over the past century. The study found that General Motors failed to recognize that its culture was not in congruence with its business environment and the culture of the global automobile industry. The primary limitation of this study was its reliance on the existing literature without researching the relationship between the current business environment and the automobile industry. Future research should delve into the existing automobile business environment including the views of those currently working in the environment.

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SUCCESSFUL MEDIA STRATEGIES FOR BUSINESS: HOW FRANKLIN DELANO ROOSEVELT AND JOHN CURTIN WON JOURNALISTS' SUPPORT©

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ABSTRACT

At the height of the Pacific war, the American and Australian leaders communicated successfully with journalists, providing valuable business strategies on how to develop positive media relations in crises. After the bombing of Pearl Harbor, Hawaii, in December 1941, the United States President, Franklin D. Roosevelt, and Australian Prime Minister, John Curtin, generated favorable news coverage about their leadership. Yet there is a lack of information on their media strategies to win journalists' support in a time of crisis. This paper shows how Roosevelt and Curtin managed to influence and persuade the news media. First, they frequently communicated to journalists in an honest, egalitarian and friendly way, increasing the number of regular news briefings between the press and the national leader. Secondly, they advanced the relatively new medium of radio to broadcast appealing, inclusive and accessible messages. Journalists repeated and amplified their radio talks in the news. Thirdly, they used practiced, forceful rhetoric and hand gestures in filmed newsreel scenes to convey their resolve and create the appearance of a direct, friendly relationship with their target audiences. These media strategies are still useful to business leaders when managing information needs in today's 24-hour news cycle.©

JEL: D83

KEYWORDS: Franklin D. Roosevelt; John Curtin; Business Communication; Media Strategies.

INTRODUCTION

Just as CEOs need to communicate a unifying vision to reassure troubled markets, Franklin Delano Roosevelt used the media to bring together diverse global audiences after the Pearl Harbor bombing. During the Pacific crisis, for example, Australian people's "admiration of his personal qualities" was "unlimited", as that country's Prime Minister John Curtin declared (1945a). Why did people in Australia and around the world develop "a personal devotion" to this United States president "rarely given by a people to any statesman other than their own" (Eggleston, 1945)? While Roosevelt is known for his stirring radio "fireside chats," there is a lack of published findings on how he managed his media relations to generate positive news coverage about his resolve to end the Pacific crisis with Curtin. Likewise, United States journalists reported on "Honest John" Curtin's eloquent radio rhetoric, likening this to the words of Civil War poet Walt Whitman because it "should have roused the fight in the entire U.S. public" (*Time*, March 23, 1942, p. 27; August 23, 1943, p. 34; August 30, 1943, p. 28). Their media strategies are useful for today's businesses when communicating information needs during a time of crisis.

Effective leadership calls for personable executives skilled in the fine art of communicating across boundaries (Fombrun, 1992; Hartog and Verburg, 1997). The most successful firms provide a common understanding of a clear and consistent corporate vision (Bartlett and Ghosal, 2002). Through their frequent messages in the press, radio and film, Roosevelt and Curtin generated mainly favorable media coverage about their alliance in World War II (hereafter the war). They developed cooperative media strategies after the Japanese military government's bombing of the Hawaiian naval base, Pearl Harbor, on December 7, 1941. Roosevelt sent about 90,000 US servicemen to Australia, a country with major military bases and a population of seven million people, by August 1942 (Curtin, 1944a; Saunders and Taylor, 1995). By talking frequently with journalists, using inclusive language and practiced, forceful

gestures, they persuaded varied public audiences to coalesce and support their strategic direction. This paper identifies the lessons of their media success for today's businesses.

To achieve this aim, the next section conducts a review of previously published literature that suggests the two leaders' expanded use of the media. Yet there are gaps in our understanding of how these wartime media strategies may apply to today's corporations, when seeking journalists' support during a crisis. This paper will set out a multimethod approach, using qualitative and quantitative analyses, to discover how Roosevelt and Curtin appealed to journalists and media audiences. These methods will determine their ability to promote their messages at news conferences, on radio and in the visual media for journalists to report favorably to enhance their public stature. The conclusion will be reached that the contemporary "Great Recession" provides an opportunity for CEOs to use these established media strategies to help restore business confidence.

LITERATURE REVIEW

A review of the literature reveals parallels in both leaders' media skills. They established a close affinity with journalists by talking about their previous newspaper experiences in media conferences. While Roosevelt enjoyed referring to his undergraduate position as the managing editor and president of his university's newspaper, *The Harvard Crimson*, Curtin discussed his former role as an Australian labor newspaper editor (Davidson, 2000; White, 1979). When Curtin visited San Francisco on April 19, 1944, for example, he said he had been a "newspaperman" at a media conference that was "the biggest and best ever held" in the city, according to a Columbia Broadcasting System (CBS) commentator (Moody, 1944a, p. 1). Appealing to journalists' sense of integrity, Curtin said they were in an "honorable" profession that necessitated a "high degree of responsibility" and upholding a "code" (1944b, p. 44-45). These press conversations assisted the two men to develop a sense of a common bond with reporters.

As Roosevelt answered journalists' impromptu questions, his interviews represented a significant departure from the more formal, structured briefings provided by his predecessors, Herbert Hoover and Woodrow Wilson (Perloff, 1998; Truman, 1945; Winfield, 1990). He generally conducted twice-weekly news conferences during his four presidential terms. This amounted to 998 interviews during slightly more than 12 years, from March 8, 1933, to April 5, 1945 (Perloff, 1998). Likewise, Curtin generally held twice-daily media briefings, well timed at noon and the early evenings to coincide with reporters' deadlines including weekends (Lloyd, 1988, Lloyd and Hall, 1997). Furthermore, he conducted at least three major media conferences in San Francisco and Washington DC in 1944 (Campbell, 2008; Curtin, 1944c; Great Britain Foreign Office, 1944). Just as Roosevelt was the first president to employ a full-time press secretary, Stephen T. Early, in 1933, Curtin appointed Australia's first full-time prime ministerial press secretary, Don Rodgers, in 1941 (Levin, 2008; Rodgers, 1971). While Curtin and Roosevelt benefited from the wartime censorship policies, and a few newspaper publishers disagreed with their ideologies, they developed mainly respectful, egalitarian relationships with journalists (Day, 1999; Serle, 1998; Steele, 1985).

Both leaders enthusiastically used the relatively new media of radio and wartime newsreels (Bonner, 1963; Day, 2000; Link, 1955; University of San Diego, 2008; Ward, 1999). Scholars have described Roosevelt's radio "fireside chats" as setting "the gold standard for American political oratory" because of his ability to project a warm, fatherly persona to US audiences (Bonner, 1963; Lim, 2003, p. 438; Link, 1955). As historical accounts vary, it is believed he gave between 25 and 31 radio "fireside chats" during his presidency (Lim, 2003). Similarly, Curtin gave radio talks from his country to US listeners (John Curtin Prime Ministerial Library, 2007). By early 1944, he and Roosevelt had developed a "very friendly and cooperative relationship" (Black, 2001, p. 225).

Likewise, the leaders' wives, Eleanor Roosevelt and Elsie Curtin, used news conferences to promote their wartime alliance, as well as to support women in business and leadership. On March 6, 1933, only two days after her husband's inauguration, Eleanor Roosevelt began weekly interviews to try to persuade US news organizations to employ at least one female journalist each. She conducted 350 women-only media conferences in the White House from 1933 to 1945 (Beasley, 2000; United States Library of Congress, 2006). Just as Eleanor Roosevelt gave media talks during her visit to Australia, Elsie Curtin conducted news interviews in Washington DC (Campbell, 2008).

As US correspondents portrayed Roosevelt's death as a shock to Americans, similarly many Australians were reportedly astonished by the loss of Curtin. Both nations' citizens seemed genuinely surprised by the news because journalists had cooperated with the two leaders and censorship policies by avoiding publishing detailed medical diagnoses of their health problems (Coatney, 2011; Evans, 2002). Curtin wrote to Eleanor Roosevelt and the new US President, Harry S. Truman, that Australians were deeply "shocked" by his death during his vacation in Warm Springs, Georgia, on April 12, 1945 (1945b, p. 34.). Similar statements were made about Curtin after he died in Canberra on July 5, 1945. Few Australians "were prepared" for the tragedy, with people quoted as saying they "didn't think it was so near." The news was reported as tributes on US press front pages (Coatney 2011). Journalists lauded the two men's resolve to remain as leaders to help achieve a war victory.

METHODOLOGY

To discover how the two leaders were able to develop positive media relations, this study has conducted a multimethod approach. First, a new examination is made of primary sources, some of which are rarely viewed, to identify the successful strategies developed by Roosevelt and Curtin in their media conferences. Secondly, through a limited content analysis, this paper investigates the keywords they emphasized to persuade audiences. Thirdly, the simplicity, accessibility and appeal of their words will be examined. The Flesch Kincaid score will be used for this purpose. This formula ranks documents on a school grade level. The recommended Flesch-Kincaid score for most public documents is about eight, close to the reading level of "middle-brow" newspapers and suitable for an eighth-grade student (Day, 2008; Lim, 2003). Rudolph Flesch first developed his readability formula as a doctoral thesis in 1943 at Columbia University's Teachers College in New York City (Sirico, 2008). Certainly, Roosevelt and Curtin were aware of the need to speak distinctly in national broadcasts (Curtin, 1941a; Ryfe, 1999). Expert recommendations have varied on the optimal pace of public speech, with some scholars advising a languid pace of one hundred words each minute (Lim, 2003) while other authors advocate 125 words a minute in a business setting (Nichols and Stevens, 1957). These formulas will be applied to a sample of Roosevelt and Curtin speeches to glean an understanding of whether their media messages were targeted effectively to global audiences.

Fourthly, it is important to discover whether these messages were reproduced favorably in the news. This analysis is based on the Pew Research Center's Project for Excellence in Journalism formula (2008) that a news article is deemed "positive" if two-thirds of the statements appear to support a leader (Public Broadcasting Service, 2009). Fifthly, while public opinion polling was new in the wartime era, these surveys indicate general support for the two leaders (Gallup, 1972; *The Courier-Mail*, August 14, 1942, p. 4; *Time*, August 23 and 30, 1943). By investigating their ability to promote their values and visions, this study will identify the secrets of their success as media communicators.

FINDINGS AND DISCUSSION

Managing the News

Although Roosevelt and Curtin cultivated good-natured relationships with journalists, they delivered their main messages forcefully to the media. For example, the president joked with the nation's newspaper financial editors at the beginning of an interview, when he said: "Of course, very few newspapermen know the difference between a dollar and a dime, anyway. But then, on the other hand, very few Presidents do. So we start even" (1942a). Yet he knew how to persuade journalists to focus on his messages. At one of his White House media conferences, he sought to influence correspondents to report on the US economic agreements with Australia. He announced: "We have been receiving from Australia enough beef and veal, practically, to feed all of our troops that are based in Australia." This "reverse lend-lease process" enabled US meat producers to send about the same amount of beef and veal to troops in Europe. "I didn't know it until this morning," he told journalists. "I grabbed hold of it and said that's the thing that has been overlooked." He also encouraged them to publish the news by saying: "That is a real headline. In the long run that is something that the country doesn't know" (1943). As a result, the press reports supported the US-Australian military alliance (Coatney, 2011).

Roosevelt's innovative news conferences perhaps influenced Australia's prime minister to hold more frequent, two-way discussions with journalists. Curtin's news interviews were unprecedented in their frequency, openness and informality in Australia (Coatney, 2011). At his San Francisco media conference, "pressmen" applauded and laughed when he joked that neither he nor Roosevelt "could get outside of the law of natural attraction" as American servicemen married Australian women (1944d, p. 35; Moody, 1944b). Despite these seemingly spontaneous interactions, Curtin was prepared to direct the content of these international media talks. When he visited Ottawa in 1944, the Canadian Prime Minister, William Lyon Mackenzie King, observed: "He seemed to attach great importance in the morning to the press interview. He came with material prepared for distribution, welcomed questions, etc" (June 1, 1944, p. 565). Just as Roosevelt had persuaded reporters to promote his "real headline," Curtin focused journalists' attention on his prepared information.

Likewise, Eleanor Roosevelt created a "delightfully informal atmosphere" and made her main points emphatically at a media conference in Canberra, Australia on September 3, 1943. Afterwards a senior Australian journalist, Joseph Alexander, wrote in his diary: "She is the greatest woman in public life that I have ever met" (September 4, 1943). Furthermore, Eleanor Roosevelt's candid media talks in Australia might have influenced Elsie Curtin's interview techniques when she visited Washington DC in 1944. Elsie became a popular media personality, who assisted her husband's US mission. Shortly after Curtin announced his trip, *The New York Times* (April 4, 1944, p. 14) and *The Washington Post* (April 6, 1944, p. 9) publishers praised Elsie's decision to "break a tradition" and travel with her husband. Eleanor promoted a firm friendship with Elsie (Eleanor Roosevelt 1944). At her first US news conference, Elsie accentuated themes of kinship by saying Australian and American women had "a good deal in common" and she would continue to support their "prominent" work in "public affairs" (1944). After her interview with Washington DC's leading female journalists, she was praised for her "honest opinions of matters American and Australian" (*Republican*, May 5, 1944; *The New York Times*, April 26, 1944, p. 20; *The West Australian*, April 28, 1944; *Valley News*, May 6, 1944). Elsie extended her US visit, resulting in *Washington Post* stories about her "busy time" as an "honor guest at luncheons" and her speech to the American Association of University Women (May 12, 1944, p. 12; May 15, 1944, p. 3). Subsequently the two women pioneered direct relationships between a national leader's wife and international journalists.

Along with their candid press briefings, Roosevelt and Curtin were adept in diverting media attention from controversies. One day after the US declaration of war against Japan on December 8, 1941,

Roosevelt announced new censorship rules at his press conference. In a persuasive manner, he added: “It is going to work out all right.” Yet one White House reporter questioned: “Will there eventually be a censor who we can get our teeth stuck into?” The president replied: “It is awfully hard to answer it. Talk to Steve [Early] about this” (1941a). By referring the journalists to his press secretary, Early, he managed to forestall more negative questions. Ultimately, reporters were willing to accept a voluntary censorship system because it was preferable to punitive war secrets laws and they recognized the popular support for fighting totalitarian enemies (Hammond, 2001).

Similarly, Roosevelt was keen to prevent undue media attention of Curtin’s visit because he was secretly resting at his advisor Bernard Mannes Baruch’s hunting and fishing lodge in Hobcaw Barony, South Carolina. Before the meeting, Eleanor confided to Elsie: “The President may still be away on an enforced holiday due to complete weariness” (1944). They kept Roosevelt’s secret. Curtin did not give details of his forthcoming trip when he spoke to 80 leading journalists at Blair House, Washington DC on April 24, 1944. Instead, correspondents positively portrayed his views on peace talks (*The New York Times*, April 25, 1944; *The Washington Post*, April 25, 1944). While detailed records do not exist, Roosevelt seemed to have enjoyed Curtin’s visit because on the same day, he cabled Churchill to confirm: “Everything goes well here in my vacation residence. The doctor agrees with me that I am better” (1944a). Early’s media release indicated only that the Curtins had accompanied Eleanor on a one-day return trip to Roosevelt’s “vacation residence in the South” (Early, 1944, p. 15). This abstruse message was repeated in newspapers and an official photograph of the cheerful visitors was published (*Republican*, May 5, 1944; *The Daily Mirror*, May 1, 1944; *The Daily Telegraph*, Sydney, April 27, 1944; *The Sydney Morning Herald*, April 25, June 27, 1944). In fact, Roosevelt revealed his “vacation hide-out” to White House correspondents only when he invited them to an interview at Hobcaw Barony on May 6. Imploring them to maintain confidentiality, he said: “I have been very comfortable down here. I want to come back” (1944b).

Their press strategies are useful for businesses when conducting media conferences and news interviews. While cultivating direct, candid and forceful communications to journalists, they knew when to divert attention quickly from potential controversies. Although they gave the appearance of informal, spontaneous press interactions, they were prepared to focus on their main messages by distributing written material and persuading reporters to accept what they considered to be a “real headline” (Roosevelt 1943).

Connecting with New Media Audiences

During their global media broadcasts, Roosevelt and Curtin deliberately selected inclusive language of unity and appealed to ideals that evoked shared meanings among different cultural groups. When Roosevelt began his Pearl Harbor announcement and his “fireside chats,” he always welcomed his media audiences with some variant of a greeting to “My Friends” (Lim, 2003). One day after the bombing in Hawaii, he attempted to instill hope in his listeners by talking of “righteous might,” “absolute victory,” “confidence,” “determination,” and “triumph” (1941b). As Curtin broadcast the first prime minister’s radio talk from Australia to American listeners, he greeted “men and women of the United States” particularly those who were “fighting,” “sweating in factories and workshops,” and “making sacrifices.” His frequent use of “we,” “us” and “our” contributed to his reassuring tone (1942a). Curtin’s appeals to freedom, democracy, and liberty were familiar in Roosevelt’s rhetoric. More than half of the “fireside chats” were published on *The New York Times* front pages, with the full texts of the speeches continuing inside the issues (Lim 2003). Such prominent news columns indicated press endorsement for Roosevelt in his home state as he was a former governor of New York. Furthermore, when he mentioned “Australia” occasionally (1942b, 1942c and 1942d), his speech was often favorably promoted on Australian newspaper front pages (e.g. *The Argus*, April 30, 1942; *The Canberra Times*, February 25, 1942, September 9, 1942). Curtin broadcast his US radio talk to more than 700 radio stations connected to the National Broadcasting Company of America, as well as to the British Isles, Canada, Europe and

South America (1942a; *The Age*, *The Canberra Times* and *The West Australian*, March 16, 1942). He received positive US press coverage and London reporters praised his “fighting message to America” (*The Age*, March 16, 1942, p. 2; *Time*, March 23, 1942). Thus, they established a semblance of a friendship with their audiences that reinforced each one’s media image as a “man of the people” (ScreenSound Australia, 1945).

Despite their theme of unity, the two leaders tried to marginalize and isolate their critics. Roosevelt “assailed his opponents ... as often as he greeted his friends” in his “fireside chats” (Lim, 2003, p. 449). During his broadcast to celebrate George Washington’s birthday, he described foreign policy isolationists as those who “wanted the American eagle to imitate the tactics of the ostrich.” He added: “Now, many of these same people, afraid that we may be sticking our necks out, want our national bird to be turned into a turtle.” Roosevelt reassured his listeners, however, that “we prefer to retain the eagle as it is - flying high and striking hard” (1942e). Likewise, Curtin branded his critics, who were opposed to his military draft policy, as “the mischief-makers outside” the government, and “abusers” whose “quarreling” would not hinder “those who have the responsibility of conducting the war” (1943a, p. 592-596). Newspaper editors copied his speech, focusing on his description of the “mischief-makers” (*The Age*, *The Sydney Morning Herald* and *The West Australian*, February 12, 1943). Yet both leaders took care to make impersonal references to “Japan,” “the enemy,” and the war. It was necessary to avoid verbal “assaults” on Japan’s revered Emperor Hirohito, according to the US government. By the first half of 1942, Roosevelt and Curtin removed official anti-emperor and racist statements that might consolidate Japanese people’s support for their military government and could become counterproductive to Allied efforts in the Pacific (Brands, 2005; Curtin, 1942b; Mowell, 1942). With the aid of speechwriters, as well as adding their personal written flourishes, they were able to portray their opponents as removed from public opinion.

Moreover, Roosevelt and Curtin advanced the use of relatively new media to aim their messages appropriately to their target audiences. Roosevelt made about nine radio talks each year during his presidential terms. Curtin broadcast about 12 significant prime ministerial radio addresses a year. In terms of the accessibility of their words, Roosevelt’s “fireside chats” were suitable for audiences with a ninth-grade reading level. A selected sample of Curtin’s radio talks was generally appropriate for tenth-grade listeners. Although the prescribed standard was for a public document to be targeted to an eighth-grade student, it appeared that they still aimed their major radio broadcasts to a predominantly lower secondary school level. This was suitable for the era, when the average level of education was eight years of schooling in the US and nine years in Australia. The Roosevelt and Curtin radio talks were accessible to global media audiences (Coatney, 2011; Day, 2008; Lim, 2003; U.S. Census Bureau, 1942).

Both Allied war leaders knew how to deliver their oratory at the right pace for their target audiences. When announcing the Pearl Harbor tragedy, Roosevelt spoke for six minutes and was reportedly interrupted by “wild and thunderous applause and cheers” in the joint session of Congress (1941b; *The Argus*, December 10, 1941, p. 5). Therefore, he spoke 86.6 words a minute; his pauses emphasized the drama and import of his words during the broadcast. In his radio talk on the same day, Curtin spoke 119.4 words per minute, which some scholars would consider an acceptable pace (1941b; Nichols and Stevens, 1957). After developing a reputation as a very fast speaker, Curtin talked calmly with Australians in like manner to Roosevelt’s reassurance that the invasion of Pearl Harbor was “a date which will live in infamy” (Roosevelt, 1941b; *The Herald*, October 4, 1941). According to different scholarly estimates, the president’s average pace was between 105 and 117 words per minute in his “fireside chats” (Bradenburg and Braden, 1958; Lim, 2003). Based on a selected sample, Curtin spoke an average 139.46 words a minute, faster than the recommended levels of 100 to 125 words (Curtin 1941b, 1942a, 1943b). Yet at the start of the Pacific crisis, both leaders spoke more slowly than they normally did to emphasize their keywords about hope, unity and a strong defence.

During his “fireside chats” newsreels, Roosevelt spoke directly to the camera at eye level, with his hands placed on the table before him to signify his straightforward manner and a close connection with his audiences. The president was framed in close-up and medium shots to convey a personal relationship with US moviegoers (Universal Studios, 1933, 1934). In a 1934 scene, for example, he removed his pince-nez glasses and looked straight at the camera to criticize “a timid few people” opposed to his policies and to emphasize his words: “I believe in practical explanations and in practical politics” (Universal Studios, 1934). In like manner to his newsreels, filmmakers started a pattern of intimate, close-up scenes that signified Curtin was leveling with the public. Filmed rehearsals showed Curtin’s determination to perfect his messages as he uncomplainingly waited for the director’s clapperboard and the call for “action!” His practice film scenes indicated he refined his memorized rhetoric, gestures and camera delivery to build “a closer relationship between the Australian and American peoples,” as he declared in a public statement. During one of his stand-ups to the camera in “take three,” for example, Curtin pointed his finger, moved his head from side to side, looking like he might be addressing an unseen audience, and said: “We know that our destinies will go forward hand-in-hand and we are proud and confident in that association.” The camera zoomed in closer during “take four” as he embellished his statement to add, “we will stand or fall together” and “we are proud *and happy* in that association [emphasis added.]” As in his other newsreels, he did not refer to notes (Coatney, 2011). Roosevelt’s innovative use of relatively new media may have influenced Curtin’s radio and film strategies. Both leaders seemed to have approved of film techniques that emphasized their direct communications and strong, decisive gestures to reassure international audiences.

They worked hard to look like skillful media performers, providing useful tips to business communicators. Their strategies included rehearsing in practice sessions so that later, they would appear to be using new media effortlessly. Moreover, they approved of close-up, eye-level visual images of themselves to establish a sense of a personal relationship with their audiences. They used assertive hand gestures to emphasize their main messages, such as when Roosevelt deftly removed his pince-nez glasses and Curtin pointed his finger as they affirmed their statements. Their unifying, inclusive language appealed to shared ideals that brought different groups together. At the same time, they portrayed their opponents as isolated from mainstream public opinion. Furthermore, they took care to use impersonal words to characterize foreign enemies so they would not alienate overseas populations. They spoke more slowly to appear calm and reassure people in a time of crisis, and selected accessible words that were appropriate for their target audiences. Their rhetoric, media images, and gestures are applicable for today’s business leaders when needing to articulate a clear vision to increasingly multicultural audiences.

The frequency of their radio broadcasts, the largely positive reception towards them in the news, the mass audiences of devoted listeners and polls suggest that Roosevelt and Curtin used the media skillfully (Lloyd, 1988; Steele, 1985; *Time*, August 23, 1943). Similarly to the president, Curtin generated mainly positive news coverage of his foreign policies (Coatney, 2011; Steele, 1985). They were successful in using relatively new media to develop a close link with public audiences. For example, Australian radio listeners enjoyed Curtin’s “periodical talks to the nation” because they liked to “hear his voice, weigh his words and generally maintain that personal contact with the head of the Government which is eminently desirable” (*The Age*, January 22, 1945). At least 12 wartime senior journalists affirmed in their reminiscences that he was a great prime minister (Coatney, 2011). Likewise, public polling conveyed the leaders’ foreign policies were mostly popular among citizens. By January 1942, Roosevelt’s public approval rating was 84 per cent, according to the Gallup poll. Another survey found 73 per cent of respondents approved his handling of foreign policy in May 1943 (Gallup, 1972). The next year he was elected to an unprecedented fourth presidential term. In a survey in Australia, eight out of 10 voters said they “were satisfied or more than satisfied with Curtin’s job as prime minister” in August 1942 (*The Courier-Mail*, August 14, 1942). During the Australian federal election in 1943, he won 66.9 per cent of the votes in his electorate of Fremantle, Western Australia. At the time, this was the greatest election victory for his Australian Labor Party. *Time* reported (August 23 and 30, 1943) that 78 per cent of

Australians supported his leadership. These types of polls and news coverage indicated the leaders' mass media strategies were successful in attracting broad support.

CONCLUSION

In a worldwide crisis, Roosevelt and Curtin provided valuable lessons on how to manage media relations. This paper has set out to identify the contemporary usefulness of these strategies for business leaders, seeking to generate favorable news coverage during a crisis. For this purpose, this study has examined rarely viewed private, officially confidential and public wartime sources to identify the two leaders' media interactions. Furthermore, the author has conducted a limited content analysis of their global media communications to ascertain their selected keywords, rhetorical emphases and oratorical pacing, as well as to discover how they targeted their messages to public audiences. Qualitative and quantitative analyses have demonstrated that, overall, journalists mainly portrayed their words favorably in the news and diverse audiences responded positively to their messages.

As today's "24/7" news forums are increasingly focusing on business executives, it is useful to understand how the war leaders used the media successfully. Roosevelt and Curtin cultivated frequent and spontaneous interactions with journalists. While they prepared thoroughly before news interviews, they showed how to create cooperative journalist relations by talking openly, rather than hiding official information from reporters, who might have discovered contentious news from other sources. Although they benefited from wartime censorship, they kept focused on promoting their main messages, directing talks from potential controversies and branding opponents as far from the mainstream. Yet they often used impersonal language when characterizing foreign enemies to avoid alienating diverse, multicultural audiences. When advancing the use of relatively new media, they selected inclusive language of unity to appeal to ideals shared by disparate populations. For the broadcast cameras, they rehearsed and cultivated close-up, eye-level images of themselves and used assertive hand gestures. These media images signified a direct, honest relationship between them and the public. Furthermore, they spoke more slowly to media audiences after the Pearl Harbor bombing, emphasizing their resolve, and targeted their words at an accessible literacy level. Their techniques are helpful to business managers as they seek to communicate a strong, unifying and memorable vision in the news.

While this paper has focused on the contemporary relevance of the Roosevelt and Curtin media strategies, the current global financial crisis provides an opportunity for future research in this area of case studies. Some seventy years after the height of the Pacific war, we have reached a new era where major forces have again converged. This includes the emergence of another global crisis, the rapid expansion of relatively innovative media and the need for skillful communicators to help restore business confidence. More research directions are opening for investigating how managers are responding to present financial challenges by using diverse media to develop positive relations with journalists.

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AN EXAMINATION OF THE ECONOMIC VIABILITY OF SUSTAINABLE BUSINESS TOURISM IN TRINIDAD

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ABSTRACT

The aim of this paper is to provide an understanding of business tourism and how it adds to sustainability and fosters economic development for countries. The paper will discuss the concept of business tourism and how it can become economically sustainable. It examines the viability of business tourism in Trinidad and makes recommendations for the future of this niche market. Furthermore, a brief assessment of the United Kingdom's business tourism industry will be presented and its policies to determine what, if any, refinements of the UK's strategies can be made to accommodate Trinidad's unique situation in the quest for sustainable business tourism. The research has revealed that business tourism is economically viable and should be pursued as a micro sector for diversifying the Trinidad and Tobago economy. The findings also embrace the notion of sustainability as a way forward.

JEL: O10

KEYWORDS: Business Tourism; Sustainable Tourism Development; Butler's (1980) TALC Model; Meetings, Incentives, Conventions and Events (MICE); Economic Sustainability; Trinidad.

INTRODUCTION

Tourism is one of the fastest growing sectors in the world (WTTC 2009). The actual and projected statistics put forward by the WTO are encouraging for countries to diversify their economy to facilitate tourism development. However, this micro sector is an extremely diverse one and differs from country to country. Each country is uniquely different and their tourism strategies and plans would depend on what resources are available.

The Latin American Studies Organization and by Discover Magazine (2010) describe Trinidad as the "Little America" and the "economic tiger" of the Caribbean. This country boasts of having the infrastructure, amenities and facilities all geared toward the business traveler and over the years, it has become the main hub for international business in the Caribbean. One of Trinidad's appealing features is that, unlike many of its neighboring islands, it offers business tourists direct flights to many international destinations including the major metropolitan cities.

Business tourism has the potential to stimulate the economy through the continuous flow of foreign exchange, create job opportunities, encourage infrastructural and social development, establish linkages with other industries and play a key role in diversifying Trinidad's oil based economy. However, despite all its charming features, it also has negative economic impacts, as this sector is capable of influencing inflation, leading to excessive demand for resources, fostering unbalanced economic development and exploitation, bringing about unwanted spill off sectors, all of which collectively increases the vulnerability of countries.

Against this background, countries seeking to employ business tourism as a diversification avenue to escape their dependency syndromes need to be very selective in identifying their developmental goals. These goals should foster an energetic business climate and attract investors. Note worthy, due consideration should be given to the sustainability and the impact this form of development will have on spill-off sectors. According to Pattullo 1996; Mowforth and Munt 1998; Ateljevic 2007; Elliott 1999; Gmelch 2004; Hall *et al* 1999; Inskip 1991 and Jayawardena 2005, business tourism apart from being a fragile industry is seen as a double edged sword that has potential for positive and negative impacts on a country's development.

The following sections of the paper examines: firstly, what the literature revealed in terms of business tourism and its economic viability in Trinidad; secondly, the methodology that was used to conduct this study; thirdly, the results and discussion; and finally, the conclusion which brings the paper to an end by summarizing the key points revealed in this study.

LITERATURE REVIEW

This section highlights the various work, views and studies in the areas of business tourism, sustainability, business tourism in Trinidad and the United Kingdom including the latter's ten-point plan.

Business Tourism

Business tourism as described by the World Travel and Tourism Council (WTTC) is referred to as the Meetings, Incentives, Conventions, and Events (MICE) market and represents a potential source of revenue, employment and international trade. 'Sustainable' and 'sustainability' are the buzz words used today. The concept of sustainable tourism is being embraced as a best practice by many countries around the world. Trinidad and Tobago is no different and in its National Policy Document; the blueprint for tourism, it has embraced the notion of sustainability as a way forward.

According to Phelan *et al* (2009), business tourism goes beyond work purposes, sports tournaments, festivals, concerts etcetera. It incorporates all activities associated with the MICE industry. Note that, this form of tourism has some peculiarities as it caters for the affluence and the professional (Jafari 2000). In this regard, business tourism caters to those of a high-income bracket and according to the Business Tourism Partnership (2003); business tourism is at the high quality and high yield end of the tourism spectrum.

Business tourism is unique in itself and it reinforces Trinidad as a preferred destination because this country is the home to many industries and it has the necessary service infrastructure to provide for this market niche. It compliments other sectors such as the leisure industry and encourages investments in business tourism facilities, which can lead to the regeneration of other areas (urban and inner city). For example, there were investments in such facilities in both Europe and the USA, which led to the regeneration of the economies (Hankinson 2005). In the local context, this country has the resources and capacity to cater to the needs of the business traveler and attract volumes of business travelers.

Lawson (1982) articulated that several factors contributed to the growth of business tourism. These include increased technological advancements in air travel, increased propensity to travel due to increased education, economic growth, rise in disposable income, and expansion of multinational companies, rapid development and growth in professional associations. Other factors are technology at the destination; infrastructure, image and funding availability determine the location of certain business events such as conventions/conferences (McCartney 2008). Swarbrooke and Horner (2001) further segmented these contributory factors into demand and supply side.

Overall, the increasing use of the internet and other forms of technology are providing organizations, individuals and businesses with innovative facilities to network, interface, redevelop the tourism product and encourage investment in tourism (McCartney 2008; Buhalis and Law 2008). The increasing use of technology has also provided companies with new ways of cutting business costs notwithstanding, the personalization of doing business.

While the above factors contribute to the growth of this niche market, challenges have marred its success and progress including the effects of September 11th; economic downturn; and increased travel cost. Air travel today has many rigorous checkpoints and restrictions, where travelling is sometimes seen as an uncomfortable experience (Business Travel News 2001).

Given these challenges, not all countries and companies experience these at the same time. For example, some emerging economies such as India, China and Brazil continue to show progress, while others are encountering recessions. While recessions have negative effects on countries, governments should put in place precautionary measures to protect, sustain and preserve the economic resources. Sustainability and sustainable development are measures taken by governments to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Sustainable Tourism Development

Sustainable tourism development builds upon the premise of sustainability. It takes into consideration the resource base that currently exists and the utilization of resources in a manner that the resource base of future generations are not impaired (Hall and Lew: 1999). Further, it promotes fairness and equality and aims to create win-win situations with the various stakeholders involved in the tourism process (Jurowski 2002). Sustainability is built on the premise that three pillars need to be satisfied. These three pillars are the natural environment (eco-friendly), the economy (financial benefits), and socio-cultural benefits (create employment opportunities and preserve culture). As such, prudent management of the three pillars would offer a positive way forward for development since it seeks the interest of all involved (Harris *et al* 2002).

However, the reality of the situation is that these pillars do not always work in harmony. Managers and stakeholders have their own interest (agency issues) and therefore it would be difficult to manage certain relationships (Elliott: 1999). One potential solution for the proper functioning of a business tourism niche is to bring the relevant stakeholders together so that they could develop a proper policy for the implementation and execution of business tourism. Tosun (2006) and Miller and Twining-Ward (2005), articulated that tourism planning has evolved and in the spirit of compromises, all stakeholders benefit (Dewhurst and Thomas: 2003).

Therefore, it is necessary to gain a holistic understanding of tourism before making comprehensive decisions. Within the tourism industry many businesses are intertwined and connected, what affects one segment will more than likely have a spill off on other segments as well (Lemmetynen and Go: 2009). Business Tourism Partnership (2003) argues that business tourism is sustainable. It offers higher benefit with fewer environmental negative impacts than mass leisure tourism.

Notwithstanding the above, business tourism can provide long term benefits if managed properly; resulting in sustained economic, social and environmental benefits over time. The main benefits of business tourism for destinations, (adopted from Swarbrooke and Horner 2001: 09) are infrastructure developments, viability of leisure facilities (shops), create opportunities for local businesses, and continuous flow of foreign exchange since business travelers tend to visit in the off-peak seasons.

Business Tourism in Trinidad and Tobago

The twin island republic of Trinidad and Tobago is the “Little America” in the Caribbean. It has a population of 1.3 million people and is one of the most developed economies in this region. It is fast becoming the economic hub of the region with many business type hotels and facilities. The country boasts of natural attractions, historical sites, and a diverse culture with various festivals, food and warm hospitable people. Statistically, the tourism sector directly accounts for about 10.6% of the Gross Domestic Product (GDP) (WTTC, 2009) and this figure is projected to rise given the government’s current diversification developmental plan. This sector provides the best opportunities for inter-sector linkages to curb many problems such as revenue leakages via high spending on imports, and curbing the problem of high food prices in society. In fact, business tourism been clearly articulated as a possible diversification strategy in the National Tourism Policy document of Trinidad and Tobago.

Over the years, studies have revealed that people prefer to do business in Trinidad. Notwithstanding, the value of the TT dollar to the US dollar (\$1 US: \$6 TT), this country offers favorable terms of trade, has the necessary financial infrastructure, business tourism facilities, information technology and human capital to facilitate international business. Theoretically, according to Butler’s model (1980), Trinidad displays symptoms of being at the Development stage of the Tourist Area Life Cycle. At the development stage, visitor numbers are climbing and the destination has to put measures, facilities and amenities in place to cater to the increased arrival of visitors. This is a phase that requires proper management (Douglas 1997; Destination Recovery 2010; and Cooper *et al* 2005).

More so, business tourism has growth potential in terms of both diversification and economic impact on the GDP. WTTC (2009) revealed that business tourism grew steadily from 2004 to 2008. The US\$ in millions climbed from 159.0 in 2004, to 200.9 in the year 2008 and it is projected to increase further to 401.6 by the year 2019. Data released from the Trinidad and Tobago Central Statistical Office (CSO) indicates that while the purposes of leisure remain high at 43%, it is not as high yielding as business tourism that accounts for 22% of the arrivals, which contributes more significantly to GDP (WTTC 2009). CSO statistics also reveal that for the period 2002 to 2008, the numbers for the business tourists increased from 66,213 to 83,998. This increase in trend shows that the country has great potential to diversify in the area of business tourism as it offers immense scope for growth and viability. It also demonstrates there is capacity for sustainability and sustainable development should the country decide to vigorously pursue this area of development.

The United Kingdom’s Business Tourism Industry

The United Kingdom’s (UK) tourism industry is ranked UK’s fifth largest industry in 2007 and it is a profitable *cash cow* that contributes significantly to its Gross Domestic Product (GDP). In 2007, the industry raked in roughly £86 and £19 billion in total revenue and foreign currency respectively. The benefits derived from this industry contributed to 8.2% of GDP in 2007, of which the direct benefits represented 3.7%. The country is an international brand with fascinating tourism features – historical landmarks, cultural roots, its geographical location and quality infrastructure and attractions (for sporting activities, conferences, art, theatre etc) among others. As a result, the UK consistently ranks sixth or seventh in the list of top destinations in the world.

Given the rise of new and mesmerizing destinations like Dubai, this country’s industry also faces obstacles including adverse market/economic conditions (global recession and credit crunch), the perception as being a posh and pricey destination, increased barrier to entry (visa requirement), inability of the Small and Medium Enterprises (which represent 80% of the 200,000 plus businesses in the tourism industry) to invest heavily in the industry, collapsing supporting infrastructure (transport in particular)

and higher tourist taxation (increases in Air Passenger Duty and charges associated with visas). These challenges are making a dent in the success of the UK's tourism industry since the country has begun to lose its competitive edge (its share of international tourist declined from 6.5% in 1980 to 3.8% in 2005).

In relation to Butler's model, our indicators reveal that the UK's business tourism industry is at the Consolidation stage of the life cycle. Key indicators employed were rising visitor numbers and already established facilities/amenities (airport, hotels and low cost carriers) that cater to a diversified range of tourists (culture, sport, shopping etc.). As consistent with Butler's theory which recommends planning and prudent management to facilitate a smooth transition into a rejuvenated niche market, the UK has commenced on a strategy for taking their industry forward (2011 Tourism Plan).

Their tourism plan examines rejuvenating downstream tourism niches by hinting of investments in these niches. There is also an indication of planning for a declining stage (knowledge management, succession planning, investments in other sectors, strategic market research) which signifies that the declining stage is not too far off and they plan to put measures in place to restart a new rejuvenated product when they get to a stagnation point where visitor numbers just peak off. The ten-point plan devised aid the country in its sustained development of the entire tourism industry is as follows:

1. Consolidate market position (traditional and emerging)
2. Engage in product development and marketing strategies
3. Advancements in ICTs (internet platform)
4. Creation of stakeholder partnerships and relevant performance measures (for accountability)
5. Formulate policy through industry engagements
6. Creation of cross-ministerial groups
7. Economic planning in public policy (due consideration to tourism industry)
8. Revamping the functions of VisitBritain (National Tourism Agency) to address performance and value
9. Securing investment initiatives from private and public sector
10. Create cutting edge marketing campaigns and solicit government support

METHODOLOGY

Data was primarily collected through the administration of a structured questionnaire to seven key local industry professionals over the period February to April 2011. The data collected was tested using thematic analysis. A qualitative research methodology was selected to gather exploratory data because qualitative research offers empirical information, deep insight and richness of detail (Neuman 2006; Minichiello and Kottler 2009; Willis 2007; Punch 2005; and Outhwaite and Turner 2007).

The paper will also shed light on the various strategies employed by the United Kingdom and discuss their applicability to the business tourism niche in Trinidad as a means of achieving economic sustainability.

A structured questionnaire was devised and self-administered, the formulation of which entailed adapting relevant questions found in the literature (Cooper *et al* 2005 and Duval 2004) with a view to answering three research questions: (i) Is business tourism a viable market in Trinidad?; (ii) Is business tourism economically sustainable?; and (iii) What are some strategies and recommendations to drive the business tourism niche forward?

The questionnaire comprised of three sections with all open-ended questions. The first section asked questions pertaining to business tourism and its importance. The second section raised questions relating to the economic sustainability of business tourism and the pros and cons of it. Finally, the third section

solicited responses on issues pertaining to strategies and recommendations regarding the way forward for business tourism in Trinidad.

RESULTS AND DISCUSSION

This section of the paper presents the responses from the seven respondents under three core themes: Business Tourism, Economic sustainability of business tourism and Future strategy and recommendations.

Business Tourism

Consistent with the literature reviewed, all respondents agreed that increased technological advancements in air travel, economic growth, infrastructure, increased education, and development of professional associations facilitated the growth of this niche market (Lawson 1982; McCartney 2008; Swarbrooke and Horner 2001; and Buhalis and Law 2008). However one respondent stated that due to the relaxation of trade barriers, it is now easier to travel and to do business. Through technological advancements business tourists can now reach their destination faster and ‘hassle free’ by engaging in online ticketing and check-in systems at a click of a button in the comfort of their offices. According to one of the respondents, *“Business tourists don’t need to walk with much cash anymore... all they need is their credit cards”*.

Three out of the seven respondents reported that the business tourism niche was a significant market to tap into. They claimed that some factors which make Trinidad a budding tourism destination are: geographic location; existing industries; infrastructure and flights; accommodation and facilities; uniqueness; experience of hosting conferences before; English speaking; and economic pricing. One interviewee stated, *“Business tourists tend to prefer the countries which speak English and follow the English legal system of doing business”*. Another interviewee expressed the sentiment, *“...we are certainly on par with the rest of the world...”* The uniqueness of Trinidad as a business tourism destination was emphasized. Trinidad has the propensity to attract people to return and do more business because it offers the sun, sea, sand, cultural attractions, gastronomic treats, and warm hospitality. Economically these are good for the country.

Five respondents claimed that Trinidad has the experience of hosting mega events and the skills in handling the Meetings, Incentives, Conventions and Events (MICE) market affairs. For example, this country hosted events such as; Caribbean Heads of Government Meeting (CHOGM), The Commonwealth Heads of Government Meeting, The 5th Summit of the Americas and events such as Miss Universe and the Cricket World Cup, and this augers well for Trinidad’s main business tourism source markets (the US, UK and Canada).

Economic Sustainability of Business Tourism

Five out of the seven stakeholders revealed that business tourists pay higher rates and the country generates more revenue to the Gross Domestic Product (GDP). They claim that business tourism is important, as it brings in a continuous stream of revenue generation throughout the year, and it adds stability to the economy. According to one respondent, *“Business tourism is not seasonal and it adds value throughout the year...it creates revenue year-round”*.

Six out of the seven respondents agreed that, *“Port of Spain has become a financial hub and offers much support services to this market”*. One interviewee stated that the exchange rate places the Trinidad destination as being more competitive when compared to other countries. Another respondent claimed that, *“... around 80% of the tourism GDP is as a result of the Meetings, Incentives, Conventions and Events (MICE) market”*. He further stated that the tourism contribution to the GDP of the Trinidad and

Tobago economy is about 10%, of which roughly 8% of this amount is related to business tourism in Trinidad. This statistic was well supported by four out of the seven respondents.

One hundred percent of the respondents agreed that business tourism can generate much needed foreign exchange. One respondent stated that, "*The indirect benefits of tourism should not be ignored, and the huge ripple impact created in the economy*". Additionally, six out of the seven respondents stated that, business tourists spend more money than any other type of traveler, and this means higher value being created. It was also reported that five of the seven stakeholders pointed out that business tourists are not price sensitive because the company pays for their trip.

However, two respondents claimed that business travelers usually return as leisure travelers to the destination. According one of the respondents, "*...There is a statistic which says that 40% of business tourists return to the destination at a later date for leisure purposes*". The other respondent agreed that business travelers offer an opportunity to double market and encourage business travelers to return later as leisure travelers. All seven respondents emphasized the impacts of business tourism on the economy. For example, the economy gains via job creation, and there is a multiplier effect as many spill-off jobs are created (taxi drivers, tour guides, entertainers, decorators and many others).

Three of the seven stakeholders recognized that by placing too much emphasis on this niche market will result in a dependency syndrome. They also stated that any recession which may occur can affect this source of revenue and the GDP of a country. One interviewee declared that, "*The price of some services can be price sensitive (economically high prices) for the business tourism sector especially in the location of such businesses*". Four of the interviewees indicated that business tourism can be more contained in one area than other forms of tourism. In this case, economic development is somewhat limited only to those areas where business tourism activity takes place at the disadvantage of other areas in a country. On the other hand, other forms of tourism such as eco tourism results in a more balanced economic development because there is a revenue trickling effect across the country.

Additionally it was revealed by six interviewees that business tourists have a preset agenda and this can hamper the trickle-down effect. Time is of essence and in most instances their trips are planned, associates are appointed as escorts and they feel more secured generally. According to one respondent, "*...business travelers have their trip planned prior to travel... they know what they are going to do when! And an associate is always in touch with them—taking them where they need to go.*"

Strategy and Future Recommendations

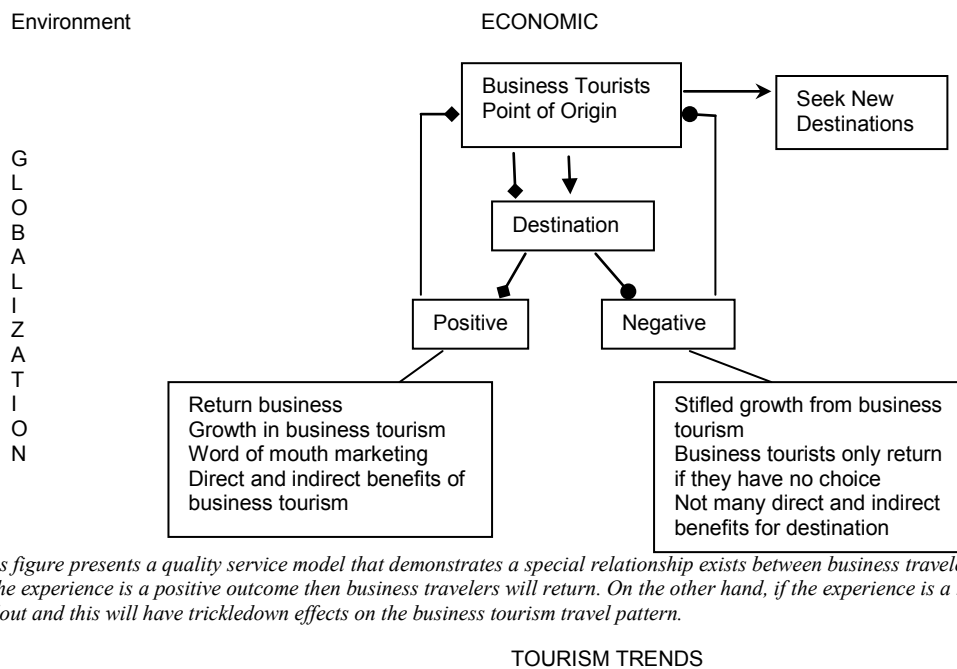
Notwithstanding the existence of a Policy document (Trinidad and Tobago tourism policy) and a master plan (Vision 2020), four respondents were very vocal that there should be a strategy for sustainable business tourism in Trinidad. They claimed that such a document should be well ventilated and suggestions and recommendations from all stakeholders should be incorporated as the way forward. It was also suggested that there are skilled professionals who have the capacity and ability to inform this policy document. What is needed is more coordination among the key stakeholders involved to move the business tourism niche forward.

The respondents shared the view that a strategy for a public awareness drive is necessary. They claimed that this can be done through education and proper communication so that even the 'common' man on the street knows that there are benefits to be derived from this industry. Communication has the ability to shape behavior and once people understand how they can benefit, they will buy-in and support such endeavors.

Respondents support the propensity of resource pooling as it affords cost effectiveness, diversification and promotes efficiency and effectiveness in business tourism. It was also mooted that benchmarking should be pursued vigorously to bring the tourism products in line with international standards. Such a focus will allow citizens to understand how successful companies compete. Cost of quality measures should be employed as it places emphasis on Total Quality Management (TQM). Quality should be instilled as part of an organization’s culture as it allows for empowerment of employees, leadership, quality training, the pursuance of quality awards and the eagerness to meet and exceed customer expectations.

Arising out of our research, a framework is presented which speaks to a quality service model that allows and showcases the importance of creating a positive service experience, which will drive business tourism as the way forward. Given the very nature of business tourism and its fragility, the strategic plan should focus on sustainability and sustainable tourism development if this sector is selected as one of the diversification efforts to move the country forward. All respondents agreed that business tourism in Trinidad was sustainable, and given their ideologies, Figure 1 was constructed. Figure 1 presents a quality service model that demonstrates a special relationship exists between business travelers and their host destinations. If the experience is a positive outcome, then business travelers will return. On the other hand, if the experience is a negative one, then business travelers are more likely to take their business elsewhere (to other destinations).

Figure 1: Business Tourism Quality Service Model



This figure presents a quality service model that demonstrates a special relationship exists between business travelers and their host destinations. If the experience is a positive outcome then business travelers will return. On the other hand, if the experience is a negative one then there will be fallout and this will have trickledown effects on the business tourism travel pattern.

Refining the United Kingdom’s Business Tourism Strategies to Accommodate Trinidad

The United Kingdom (UK) being at the consolidation stage implies that they would have passed the development stage where Trinidad is currently positioned. Therefore their strategies can be examined in light of Trinidad’s Meetings, Incentives, Conventions and Events (MICE) market and can be possibly molded into bespoke strategies and adopted in Trinidad to gain a competitive advantage.

It is important to note that the UK’s plan did not focus on Business Tourism alone; instead it encompasses their tourism market holistically and addresses strategies to drive the entire sector forward. Therefore, the strategies which follow will have to be tailored to suit the Trinidad’s MICE market. These strategies are identified in Table 1. Table 1 identifies the relevant tourism strategies employed by the UK (as per its ten-point plan mentioned earlier) and possible strategies that can be adopted by Trinidad in its quest for sustainable business tourism. In essence, the table examines how the UK’s tourism strategies can be refined to accommodate Trinidad’s market to enable Trinidad to become more competitive.

Table 1- UK Tourism Strategies and its Adoption by Trinidad

UK Tourism Strategies	Potential Adopted Strategies for Trinidad
Consolidate market position (traditional and emerging) by engaging in product development and cutting edge marketing strategies	The Caribbean on a whole could consolidate its market position utilizing institutional relationships with other islands and regional bodies such as CSME (Caribbean Single Market and Economy), and the CTO (Caribbean Tourism Organization) to get more mileage via advertising and destination awareness. Just as the UK is promoting its various countries like England, Scotland, Wales and Northern Ireland, Caricom can promote specialty products in the region, for example, Dominica as eco tourism, Barbados as leisure tourism, Guyana as soft adventure, and Trinidad as business tourism. In Trinidad’s context more aggressive marketing can be done to enable business tourism to reach a wider catchment area. The TTCB (Trinidad and Tobago Convention Bureau) was set up in 2009 with the specific intention to market and facilitate this business tourism market.
Solicit government support and timely feedback	The communication channel between government and the business tourism industry should be improved so that action can be taken faster to remedy any negative impacts and to speed up decision making. The end result would be meaningful results to business tourism.
Creation of stakeholder partnerships and relevant performance measures (for accountability)	A stakeholder approach (multi-stakeholder collaboration as identified in the National Tourism Policy Document) can be used to get buy-in and support and have everyone pulling in the same direction. Partnerships with international professional associations should be encouraged so that members of local associations can gain international exposure and experience.
Advancements in ICTs (internet platform)	Building upon strong information communication technology can be an advantage to not only build destination awareness but to attract investors by showcasing what resources Trinidad has to cater to the MICE niche. Using ICTs will promote a virtual experience and this will: maximize consumer reach; provide a better, more engaging customer experience; and provide a techno savvy platform which will be more eye catching and appealing than other countries in the region. Business persons are attracted to technology, internet, destinations which offer convenience in business and therefore Trinidad should position itself accordingly for this market.
Formulate policy through industry engagements	Future policies should be created by engaging industry stakeholders. Even though this process may be painstaking, the outcome would be a collaborative and holistic policy where everyone buys-in to a common goal and takes the industry forward.

This table identifies the relevant tourism strategies employed by the UK and possible strategies that can be adopted by Trinidad in its quest for sustainable business tourism.

CONCLUSION

The global travel and tourism industry, despite being battered by shock waves (global economic downturn, epidemics, peculiar climate events, unpredictable oil prices among others), has proved that it is a force to be reckoned with given its resilient nature. Specifically, Trinidad can gain immensely if the business tourism option is pursued vigorously. All respondents agreed that the diversification into business tourism was economically sustainable and it offers one of the best linkages to other sectors. The challenges articulated are not insurmountable and with collaboration from the key stakeholders there exists a potential for emerging economies to gain developed status. Government must support and

partner with industry stakeholders to effectively manage the business tourism market in Trinidad. Trinidad should also consider implementing the refined strategies identified in this paper, which have been tweaked from UK's ten-point plan, in its quest for sustainable business tourism. This study brought forth an exploratory understanding of where this niche is positioned presently and showcases that business tourism can be a valuable market to tap into.

Like other studies, this exploratory research work has some limitations. For example, the sample size examined is small and one should be very careful when generalizing. Another limitation is that this study did not examine the environmental and socio-cultural impact of business tourism. Cost and time were also constraints when this study was undertaken. Additionally, the results and findings were somewhat restricted given that the literature search found little empirical work on business tourism in Trinidad.

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CONVERGENCES AND DIVERGENCES RELATED TO FAIR VALUE

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ABSTRACT

Many authors present the advantages of fair value accounting, but others contest this concept, because of its volatility and subjective tendency of the models used for the evaluation. The advantages of fair value include utility, relevance, transparency and superior accuracy of the results, provides more clarity to the financial statements, it provides a total accounting of the comparable value and it gives more liability to the manager. However, critics of fair value accounting do not provide credible alternatives. Do we go back to historical cost accounting, wherein the financial assets are stated at outdated values and hence are not relevant or reliable? In the current crisis, a question is: Should assets be marked down to their current throw away prices, as companies may not want to sell them at those values? This paper analyses this question, and various controversial issues related to the concept of fair value as it is currently presented by IASB and FASB.

JEL: L26

KEYWORDS: Fair Value, Standards, Accounting, Assets, Liabilities.

INTRODUCTION

Fair value is a relatively new concept. It did not figure in the academic debate on current values in accounting that raged in the 1960s. In those days, current values were debated as alternatives to historical cost, and to one another. They included replacement cost (Günter 1966), net realizable value (Chambers 1967) and deprival value (Baxter 1967). The term fair value seems to have been used first by accounting standards setters in the United States and has subsequently appeared in UK standards, in international standards and in the Directives of the European Commission, in addition to some more recent US standards. The use of the term by standards setters has been to describe, rather loosely, a market-based current value, as opposed to traditional historical cost. The precise application of fair value has varied from standard to standard, and the United States Financial Accounting Standards Board (FASB) has recently developed a standard which prescribes a uniform method of calculating fair value, to apply within all standards that currently use the term. An exposure draft was issued in 2004 and the final standard was published in September 2006. The International Accounting Standards Board (IASB) is committed, as part of its international convergence program, to issuing a discussion paper (the first stage of its process for developing a standard) based on the new FASB standard.

In this context, the national and international intercessions have as a target realizing a convergence between national and international norms for a unique value (fair value). The appliance of this concept impose the outlining of it's utility, the knowledge of attaining techniques, assures much better than the historical cost the qualitative accountancy information and gives a plus to the user's certainty. This occurs because these will be able to avoid negative aspects, of the interest-evaluations and reliability of a patrimonial entity.

With the FASB, in Statement of Financial Accounting Standards 157 Fair Value Measurement, determined that fair value is an exit price notion; the IASB is left to decide whether or not it agrees.

Preliminary indications are that while the IASB may largely agree with the FASB's articulation of exit price, it may also see the need to articulate an entry price notion. The need results from the perceived use of that notion under the banner of fair value in some IASB standards. More specifically, some may make a case for the use of entry price on initial recognition of an asset or liability with a switch to exit price for subsequent measurement.

The fair value option is a small step in the direction for making US Generally Accepted Accounting Principles (GAAP) more harmonized with international GAAP. The main point in this module is that fair value adjustment of all financial and non-financial items on the balance sheet will not necessarily bring the balance sheet significantly closer to the fair value of the firm as a whole. The problem is that firm value is most likely highly impacted by unregistered items that do not appear on the balance sheet and cannot be adjusted for fair value. Debate should therefore centre on the measurement attribute to be used in assessing an asset's recoverability; fair value, or the higher of the value in use and fair value less selling costs.

According to IFRS 13 changes in fair values reflect the effects of changes in market conditions when they occur. Therefore, they reflect the effects of management decisions to buy, sell, incur, extinguish or hold financial assets or financial liabilities on a timely basis.

LITERATURE REVIEW

Fair value is usually defined as a current market price. The definition in current international financial reporting standards (IFRS) is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable and willing parties in an arm's length transaction" (IASB 2006, 2304).

The FASB fair value measurement standard defines fair value as the price that would be received when selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (FASB 2006). The new definition resolves two alternatives to fair value as follows. First, the reference to price rather than amount makes it clear that transaction costs are not included in fair value. If they are included in the measurement, the correct description would, in the case of assets, be fair value, less cost to sell. Second, the reference to received from selling an asset and paid to transfer a liability clarify the choice of market, by specifying the exit market rather than the entry market.

There are two distinct dimensions to the consideration to fair value alternatives. The first is to examine alternative current values, and the second is to consider historical costs. Discussions of fair value often fall in to the trap of debating the relative merits of fair value and historical cost while ignoring the existence of alternative current values. Thus fair value can, wrongly, be regarded as the only alternative to historical cost. In order to avoid giving this false impression, the current discussion will focus first on alternative measures of current value.

Like fair value, other current value measures have a number of alternative definitions and their classification into generic groups is far from simple. Here we adopt the classification used by the Discussion Paper on measurement bases, published recently by the IASB (IASB 2005). APB Opinion No. 16 (1970) on business combinations is an early example. The term fair value subsequently became widely used to describe the measurement basis used in the revaluation exercise required by acquisition accounting for initial recognition of an acquired entity. This includes an entry value, current cost (subdivided into reproduction cost and replacement cost), two exit values (net realizable value and value in use) and one method that combines both entry and exit values (deprival value). For the sake of simplicity, the subsequent discussion is conducted in terms of measuring assets, although most but not all of it is equally relevant to liabilities. For example, due to the financial nature of liabilities, the distinction between

reproduction cost and replacement cost is not generally relevant. A useful analysis of the recognition and measurement of liabilities is in Leonard 2002.

It is not surprising that there appears to be some consistency between recent IASB statements discussed above and recent FASB comments. On 23 June 2004, FASB issued an Exposure Draft of a proposed Statement titled Fair Value Measurements. This proposes a definition of fair value as the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties. This definition seems at pains to preserve semantic differences between FASB and IASB, rather than to seek convergence. FASB proposes a hierarchy of the inputs which should be used to estimate fair value (note that this hierarchy is concerned with measurement estimations, not with definition).

At the joint meeting of the IASB and the FASB in October 2005, the boards established explicit long-term objectives for improving financial reporting for financial instruments, to help the boards evaluate and prioritize future projects on financial instruments. In addition, the boards agreed to work towards those long-term objectives while retaining the ability to work either jointly or separately on shorter term objectives that are consistent with the long-term objectives.

An interesting slant on all this is given by the Discussion Paper *Measurement Bases for Financial Accounting-Measurement on Initial Recognition* (IASB, 2005). This document was written by staff of the Canadian Accounting Standards Board and published for discussion by IASB, and several other bodies. This proposes a four-level measurement hierarchy for assets and liabilities on initial recognition, as follows. Level 1: Observable market prices are any adjustments consistent with those that market participants may be expected to make. Level 2: Accepted valuation models or techniques which are all significant inputs consistent with those that market participants may be expected to use. Level 3: Current cost (i.e. reproduction cost and replacement cost) with the possibility of substituting historical cost, provided a reliable estimate can be made and the amount may be expected to be recoverable. Level 4: Models and techniques that use entity-specific inputs only when unavoidable. This is done only when not demonstrably inconsistent with those that market participants can be expected to use.

In 2006, FASB issued a new standard, FAS No. 157, Fair Value Measurements, which provided a single, consistent definition of fair value, established a common framework for developing fair value estimates, and required expanded disclosures about those estimates. FASB issued FAS 157 to address the complexities caused by differing definitions of fair value. Stated differently, FAS 157 itself does not prescribe any particular accounting treatment or require fair value accounting but does specify how fair value is to be determined when fair value is required by another standard.

FAS 157 establishes a hierarchy of valuation techniques that varies based on the availability of observable market information. Level 1 inputs are observable market data such as the quoted price for an identical stock or bond in an active market. Level 2 inputs are other observable market data such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; interest rate, yield curve and similar data that are observable at commonly quoted intervals; and other data that may be corroborated by market data (mark-to-market measurements). Level 3 inputs are unobservable firm supplied estimates, including the reporting entity's own analysis of the underlying economic data that market participants would factor into the pricing of the asset or liability (mark-to-model valuations).

Convergence regarding fair value does not imply the failure of accounting harmonization, but an obvious intercession aimed towards using an appropriate communication in a globalizing context. The goal is to have a common reference, International Financial Reporting Statements, while the short term goal of convergence is to eliminate the individual differences between US GAAP and the current IAS IFRS. Within this short term project, FASB analyzes various issues and either suggests alterations in the

American norms, in order to eliminate differences or it communicates to IASB the reason for which it decided not to alter the provisions of US GAAP. At the same time IASB is carrying on a process of revising IFRS for the same measures as FASB.

On 12 May 2011 the IASB and the FASB issued new guidance on fair value measurement and disclosure requirements for International Financial Reporting Standards (IFRSs) and US GAAP. The concept in IFRS 13 is that there are many types of factors which are taken into account in fair value. We can estimate if they are (1) a characteristic of the asset or liability in question rather than a characteristic of the entity that holds the item and (2) they would influence market participants' pricing decisions. Even though IFRS 13 became a convergence guide regarding fair value, there are also differences between US GAAP and IFRS. These differences refer to the recognition of day one gains and losses when fair value is determined using unobservable inputs. It also refers to measurements as a certain alternative have a practical expedient in an investment company without a readily determinable fair value.

To sum up, IFRS 13 clarifies that fair value is a current price at the measurement date and explicitness reference to 'market participants', emphasizing that fair value is a market-based concept and assuming an orderly sale or transfer. There are also specialists who criticize the limited use of fair values in IFRS.

THE FAIR VALUE AGAINST THE HISTORICAL COST

Historical cost is a method of measurement traditionally used by accountants. It measures an asset at the cost of acquiring it. This provides a reliable basis for measurement, but an obvious disadvantage is that, as price change subsequent to acquisition, the relevance of historical cost declines if the objective of measurement is to reflect the current economic benefit represented by the asset. Moreover, it is possible that, in some cases, the transaction did not take place at market price (as in the case of bargain purchase) so that the transaction price did not represent the current economic benefit conferred by the asset, even at the moment of purchase. This comparison holds between historical cost and each of the current value alternatives described above. Each of the current values measures a current rather than a historical attribute of the asset and looks to the market rather than the specific transaction for evidence. But this leads, in each case, to a degree of estimation, because the current measures are not based on actual transactions but upon transactions that might take place in markets that are far from perfect and in the extreme, may not even exist. Hence, current values include gains or losses in value that are unrealized, where as historical cost does not amend the measurement arising from the acquisition transaction until the gain or loss is realized in a disposal transaction.

These historical cost benefits are obtained by sacrificing relevance to the current economic opportunities represented by the asset. From that perspective, historical cost loses its relevance as time passes and prices and opportunities change. Moreover, historical cost will measure otherwise identical assets of the same entity at different amounts, depending on the specific acquisition cost prevailing at the time of acquisition. Thus, it does not provide either a timely or comparable basis for measuring the economic benefits conferred by the ownership of an asset.

There are clearly several plausible alternatives to fair value. In choosing between them, it is necessary to have criteria with which to weight their relative costs and benefits. The conceptual framework of various accounting standard setters attempt to provide such criteria although no standard setter has yet taken the courageous step of choosing a single valuation basis as superior to the others. Thus, the extant standards are based upon mixed measurement systems. Current values and historical costs are used in different standards and sometimes as alternatives within the same standard. The selection of alternative current values also varies. Sometimes it is described as fair value and other time is not. Even when fair value is the prescribed measure, as in several of the current IASB and FASB standards, the precise application of

the term is not the same across different standards. Removing such inconsistencies is the main objective of the current FASB and IASB project in fair value measurement.

The fundamental measurement issue is not application guidance and the choice of evidence to support measurement, but rather it is to determine the guiding objective of the measurement process. The primary objective of accounting, and therefore of measurement in accounts is, according to the conceptual framework of the IASB and the FASB, relevance to the need of users. Those needs are assumed to arise from economic decisions that users have to make. These decisions are assumed to be primarily made by an investor, and therefore relate primarily to the prediction of future cash flows. However, prediction does not imply merely forecasting, and the concerns of stewardship are also assumed to be included in the objective. Stewardship implies accountability by management to investors. The feedback this provides is relevant to future cash flows because it will affect the future conduct of management and confidence which investors place in the entity's prospects.

In practice cost/benefit considerations seem to rule out an unconstrained multiple column approach, and the need for comparability suggests that the single measurement is given prominence in the accounts should be chosen by reference to consistent guidance, so that like transactions and events are recorded in a similar manner. This requirement does not rule out measurement methods such as deprival value, which may use a different measurement method in different circumstances. This occurs because such a method will always treat like circumstances in a similar manner. Equally, it does not rule out systematic valuation of different types of asset on a different basis (e.g. current assets at selling price and fixed assets at cost); such an approach might be chosen on cost/benefit grounds if fixed assets are expensive to value and the resulting valuations are unreliable. However, when the cost measure used is the historical cost, it could be argued that such measures cannot be compared in an economically meaningful way because the measure is dependent on the time of acquisition, which will differ across different assets.

Many academic writers advocate that a single measurement method be applied to all assets. This would have the obvious benefit of enabling different types of asset to be compared without having to allow the changes in valuation method and would also remove possible errors or bias arising from different classification methods being used by different entities or at different times. However, it seems likely that, in practice, cost/benefit considerations may justify the use of different measurement methods for different categories of asset (e.g. when market evidence is unavailable or expensive). In the latter case, it may still be helpful to users to have a common valuation objective, imposing consistency of purpose even if the techniques used to achieve it may vary according to asset type. Moreover, it may be preferable to choose techniques by reference to specific circumstances rather than asset type. Thus, it would be the actual absence of market information, rather than asset type that would justify the use of an alternative technique, so that the measurement objective would always be followed as closely as was permitted by the available evidence. This is the approach adopted by the fair value hierarchy discussed above.

The positive result of the theoretical debates of the 1960s was to demonstrate the potential usefulness of different current valuation bases, such as replacement cost, net realizable value and deprival value. Fair value accounting, also referred to as "mark-to-market" accounting, has played an important role in U.S. generally accepted accounting principles (GAAP) for more than 50 years. Beginning in 1979, SFAS 33 required large corporations to provide a supplementary schedule of condensed balance sheets and income statements comparing annual outcomes under three valuation bases: Unadjusted historical cost, Price-level adjusted (PLA) historical cost, and Current cost entry value adjusted for depreciation and amortization. Companies complained heavily that users did not obtain value that justified the cost of implementing SFAS 33. Analysts complained that the FASB allowed such crude estimates that the SFAS 33 schedules were virtually useless, especially the current cost estimates. The FASB rescinded SFAS 33 when it issued SFAS 89 in 1986.

In 1993, FASB expanded the fair value recognition requirements by issuing a standard that required debt and equity securities that were held for trading or held for sale to be carried at fair value in the balance sheet and required changes in fair value to be recognized in the income statement or in a category of equity referred to as other comprehensive income. This was augmented in 1998, when FASB standards were adopted that required derivatives to be measured at fair value.

The new concept regarding harmonization or convergence is concerns professional organizations and users of the fair value concept. The IASB and FASB make mention that fair value is used extensively or excessively. Although, the conceptual frameworks were published some time ago, we have witnessed a meteoric rise in the use of fair value as a measurement basis in financial reporting. The great challenge in recent decades is related to the identification of methods and indicators able to measure the effects that fair value produce in the new economy. Thus, the most recent studies have focused on developing tools to facilitate a better understanding and representation of fair value, the meaning of this concept and presentation in a form without substance and in a substance without form.

CONCLUSIONS

There are a number of plausible alternatives to fair value. The choice will depend upon the specific circumstances of the entity and the needs of account users. In an uncertain world with imperfect and incomplete markets, no particular measurement objective should be regarded as having a monopoly, and different measurements should be regarded as complementing one another.

Fair value is here to stay. It is already deeply embedded in IASB and FASB literature and there are growing calls from the user community to increase its use in financial reporting. Conceptual support for fair value is demonstrable and will be further underpinned in the revised conceptual framework. Users, auditors and regulators will become more comfortable with the use of fair value as time passes.

Moving from theory to practice, the question perhaps becomes: What are the informational advantages and disadvantages of the practicable proxies to fair value both when applied consistently, and when applied pragmatically on an item-by-item basis? This takes us back to the academically traditional debates on the pros and cons of the various theories of income measurement and asset valuation. Many academics have strongly held view on these issues. But since fair value notion seems not to alter these debates, we leave our views until another occasion.

Credibility regards a reasonable evaluation and the using of market information in all possible situations for evaluating and justifying the subjective arguments. Starting from these concepts, the users of the accountancy information had demanded development of a model for a general appliance of fair value. In essence, therefore, this concept in context of new economy gives a significant push towards current values in general and towards fair value in particular, but also strongly insists that fair value , as such must be genuinely based on *market* expectations, again, not entity- specific. We consider that fair value is an attempt at current economic values, and current value in an active market is a proxy for it. But whether or not IASB sees it this way is not yet proven.

We strongly support current values and regard fair value as a valid contender for an appropriate current value. But, like EFRAG, we are not at all convinced by the apparent determination to avoid entity-specific measurements.

Convergence especially regarding fair value is not an easy thing! Even the president of FASB declared that the greatest challenge of the convergence process was to persuade the national business communities of the necessity for an international accounting language. Even if the Securities Exchange Commission (SEC) and multinational companies in the USA are privileged by this convergence, small companies and

the family level businesses are less happy. Perhaps people don't like change in general, preferring rather to keep their status quo.

IFRS 13, which is effective from 1 January 2013, defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 does not determine when an asset, a liability or an entity's own equity instrument is measured at fair value. Rather, the measurement and disclosure requirements of IFRS 13 apply when another IFRS requires or permits the item to be measured at fair value (with limited exceptions).

We can conclude that IFRS 13 Fair Value Measurement will improve consistency and reduce complexity by providing, for the first time, a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. On the other side, this standard reflects the FASB's consideration of the different characteristics of public and non-public entities and the needs of users of their financial statements.

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OUTWARD INTERNATIONALIZATION AND FDI: MOTIVES FOR MALAYSIAN MNES MOVING INTO CHINA

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ABSTRACT

Firms are pressured to operate globally to reap the benefits of other locations through foreign investment. This phenomenon occurs not only among multinational enterprises from developed countries but also younger multinational enterprises from developing countries. Various factors induce them to invest in foreign locations. This paper highlights the motives of multinationals from developing countries engaging in foreign locations and capitalizing on location to enhance their competitiveness. This study uses one Malaysian company's experiences to analyze the situation through a qualitative analysis. The results show that intense competition in the domestic and global market has forced firms to move out of their home country and relocate their production centers in China. China offers various factors that entice Malaysian MNEs to escalate their global expansion.

JEL: F2, F21, F23

KEYWORDS: International Factor Movement, International Investment, Multinational Firms, International Business

INTRODUCTION

Multinational enterprises (MNEs) from emerging countries engage in outward foreign direct investment (OFDI) all over the world. Outward investment from emerging countries in 2005 was USD 1.4 trillion, an increase of 300 percent since the last decade (UNCTAD, 2006). Outward investment has become an integral part of corporate growth strategies for multinational firms to sustain their competitiveness. Multinational enterprises (MNEs) from emerging countries are currently focusing on developing their cost efficiency and utilizing resources. Thus, investing abroad is an alternative way of expanding and improving efficiencies, primarily in managing the costs of operations. Emerging countries like Malaysia are surrounded by other countries that are also rapidly developing, like China and Vietnam. Proximity to high potential locations may trigger the local firms to exploit such advantages. New MNEs from emerging countries like Malaysia are presently extending their global reach to emerging and developed countries. Moving abroad is mandatory to cope with competitive market pressures.

Another central issue that is frequently a challenging problem for MNEs from emerging markets is deciding in which country to invest. Relevant queries involve questions such as which country is the best location, is the location strategic for the investment, how can the location benefit the firm, and finally can the investment location help to enhance the firm's capabilities and efficiencies. Malaysian firms are keen to expand to foreign locations as the local market is becoming more competitive. This is due to the fact that the Malaysian market is smaller than in other emerging countries and the local market is unsettled by intensifying competition from foreign firms in the country. Malaysia was a targeted foreign investment destination in the 1980s and 1990s. However, at the moment it has shifted its position from being an investment recipient to an investment contributor by increasingly engaging in outward investment. The economic significance of Malaysia's outward foreign direct investment is increasing; Malaysia was in 32nd position in the period of 2003-2005. More recently, Malaysia was in 11th position among 128 economies worldwide (UNCTAD, 2009). Inflow of foreign direct investments into Malaysia in 2010

amounted to USD9.2billion but Malaysia's outward direct investment in other economies abroad was much higher at USD14.2billion (Central Bank of Malaysia, 2010). Since 2004, several Malaysian companies have expanded their international operations vigorously through various investments abroad. Indeed some of firms were included in the Top 100 non-Financial Transnational Corporations. For instance, the top three Malaysian companies include PETRONAS which ranked second, YTL Corporation which ranked thirty-second and MISC which ranked forty-fifth (UNCTAD, 2006).

The internationalization literature widely discusses the motives for MNEs from developed countries selecting emerging countries as foreign investment destinations (Hymer, 1960; Dunning, 1998; Porter, 1986; Defever, 2006; Guillén & García-Canal, 2009). Nonetheless, unlike large and well established MNEs from developed countries such as the USA, UK, Japan and Germany, MNEs from emerging countries are smaller and less capable in terms of resources such as human and financial capital, technology, and skills. Despite this fact, there is increasing growth of outward investment from MNEs of emerging countries to foreign locations.

Studies have been conducted and several theories have been developed relating to internationalization and outward foreign direct investment. These theories include the eclectic paradigm, transaction cost theory and the Uppsala model based on the observation of western countries. Though these theories and models can be applied to MNEs from emerging countries, empirical evidence on them is limited. Most of the discussion about internationalization and foreign investment is centered on economic perspectives and evidence on these issues from the strategic management point of view is not extensive. A great deal of research has also been conducted on MNEs from developed countries investing in emerging countries.

Studies on MNEs of emerging countries investing in other emerging countries in the strategic management literature are somewhat inadequate. Thus, this study sheds light on these rising issues by examining how MNEs from emerging countries are involved in internationalizing through foreign investment in other emerging countries. It is worth noting that MNEs from emerging countries are aggressive in seeking new market and production centers abroad. MNEs from emerging countries are relatively young and lack of international experience and resources. For this reason, their decisions to expand in foreign locations is highly risky. Nonetheless, despite these facts some of them manage to achieve a remarkable growth in foreign locations. The desire to comprehend this phenomenon has triggered this study to explore further the activities of MNEs from emerging countries in terms of their internationalization to other emerging locations such as China.

This paper seeks to examine the reasons or motives for Malaysian MNEs' international expansion primarily to China, as one of the leading emerging countries in the world. This paper also analyzes the attributes that China possesses as an investment destination for many MNEs from various countries. Finally, this study evaluates the advantages that China offers as an investment location for foreign MNEs. This paper will firstly discuss internationalization and the motives of MNEs investing in foreign locations, and then the paper highlights the significance of China as a strategic choice as a foreign investment destination. Secondly the paper discusses how Eng Technology embarked on its internationalization through foreign direct investment, and finally the paper reveals the drivers and motives for the Malaysian firm's entry into China.

INTERNATIONALIZATION AND MOTIVES THEORIES

Hymer (1960) asserts that MNEs should have certain kinds of proprietary or ownership advantages that differentiate them from local firms. The economic conditions and ownership advantages that they have enables them to embark on investment in foreign locations. MNEs may engage in global expansion either vertically or horizontally. The crucial condition for engaging in vertical expansion is the presence of a comparative advantage in the foreign location that includes the cost associated with production factors

such as capital, labor, or land (Guillén & García-Canal, 2009). Horizontal expansion arises when MNEs establish a delivery facility in a foreign location to exploit market opportunities without abandoning production in the home country. The decision to engage in horizontal expansion is motivated by forces such as protection barriers, high transportation costs, hostile currency exchange rate shifts, or requirements for local adaptation.

In developing ownership advantages, MNEs require a gradual and incremental growth in their international expansion. MNEs expanding abroad may start by entering a country that has socio-cultural similarities as elaborated in the Uppsala model (Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975). Firms typically embark upon foreign investment in countries that they can easily understand and then move to a distant market at a later stage, which is referred as psychic distance (Johanson & Vahlne, 1990). By doing so, firms are able to reduce market uncertainties and lower the risks of failure in the foreign markets. The ability of a firm to internationalize early and succeed in foreign markets is influenced by the internal capabilities of the firm (Autio et al., 2000; McDougall et al., 1994; Zahra et al., 2000). Internationalization is an innovative act, as it provokes the development or improvement of products and new methods for doing business (Casson, 2000; Dosi, 1988; Nelson & Winter, 1982). The resource based view (RBV) helps to explain how knowledge and internal capabilities are developed and leveraged by firms (Grant, 1996; Penrose, 1959; Wernerfelt, 1984). Differential endowment of resources is an important determinant of internal capabilities and performance (Barney, 1991; Grant, 1996).

MNEs typically internationalize through foreign investment for reasons and motives which include market seeking, efficiency seeking, knowledge seeking and strategic asset seeking (Dunning, 1998). Consistent with Dunning (1998), UNCTAD (2006) also reported that a firm's engagement in internationalization can be the result of a wide array of stimuli, which can be classified into market seeking, efficiency seeking, resource seeking and asset seeking. The theory of strategic asset seeking was developed from major contributions of theoretical developments published over the last fifty years, particularly in internationalization theory (Buckley, 1990; Buckley & Casson, 1976; Coase, 1937; Dunning, 2003; Penrose, 1959), the eclectic paradigm (Dunning, 2001) and the macroeconomic approaches (Kojima, 1982; Kojima & Ozawa, 1984). Most MNEs from emerging countries claim that one of the reasons for investing abroad is to access foreign markets or to gain proximity to potential clients, which comes under market seeking. Sales activities is another example of market seeking investments, while production involves efficiency seeking or knowledge seeking, research and development involves knowledge seeking, and corporate support such as headquarters and shared service functions involves strategic asset seeking.

Porter (1986) and Defever (2006) distinguish MNEs' involvement as either upstream activities, meaning firms that are involved in creating products or downstream activities which means firms that are involved in selling and servicing products. In upstream activities, MNEs typically engage in creating backward linkages into sources of raw materials and increase their opportunities in the relationship between the firm and the supplier of the raw material. On the other hand, in downstream activities, MNEs typically engage in forward linkages into foreign markets in order to reduce uncertainty and enhance the relationship between the firm and the distributor or agent in the foreign market. MNEs from emerging countries also normally look for global expansion as a way of managing the restrictions implemented by the home country government in the domestic market. In many emerging countries, restrictions such as licensing systems, quota allocations, and export restrictions put pressure on MNEs to grow extensively, thus pushing them to expand abroad (Lall, 1983; Wells, 1983). Furthermore, firms also realize the need to spread the risks by locating assets in different countries (Lecraw, 1977). This motivation is driven by the macroeconomic and political volatility attributes of many emerging countries, which expose the firms to the threat of government nationalization and confiscation (Wells, 1983). Consistent with Porter (1986) and Defever (2006), earlier findings on MNEs from emerging countries also emphasized buyer-supplier relationships as motives for a supplier establishing production facilities in a foreign country in which the

buyer already had a presence (UNCTAD, 2006; Wells, 1983). In some cases, both the buyer and the supplier are home country firms that have followed each other abroad, while in others the buyer is a multinational from a developed country that asks its supplier in an emerging country to relocate either to its home country or to other countries (Guillén, 2005).

Scholars are also paying attention to the proprietary or firm-specific intangible assets of MNEs from emerging countries. They argue that these MNEs engage in FDI with the purpose of not only acquiring such assets but also exploiting existing ones. Global expansion for MNEs from emerging countries with the purpose of acquiring intangible assets, especially technology and brands, was not that significant in the 1970s and 1980s, but the situation has become more prevalent in the last two decades (UNCTAD, 2006). The liberalization of current accounts and currency exchange in many emerging countries has given more freedom for these MNEs to participate in acquisitions, which are very costly. Many poorly performing firms or divisions in developed countries, especially in the US and Europe, that possess brands and product technology that could improve the competitive position of MNEs from emerging countries have been exploited due to their superior or efficiency capabilities. Acquisitions have not been the only way to gain access to intangible assets. The evidence suggests that the acceleration in the international expansion of the MNEs from emerging countries has been supported by many international alliances aimed at gaining access to critical resources and skills that allow these firms to catch up with MNEs from developed countries. As argued above, these alliances and acquisitions have been critical for these firms to match the competitiveness of MNEs from developed countries. For this reason, the international expansion of MNEs from emerging countries runs in parallel with the process of upgrading their capabilities. Sometimes, however, capability upgrading precedes global expansion. This is the case, for instance, for some state-owned enterprises that undergo a restructuring process before internationalization and privatization (Cuervo & Villalonga, 2000). In other cases, the capability upgrading process can follow international expansion.

CHINA AS A STRATEGIC LOCATION

MNEs from emerging countries are increasingly seeking locations which offer the best economic and institutional facilities for their core competencies to be efficiently utilized. Foreign direct investment patterns and motives must also be examined over time, because factors favoring a MNE's initial investment into a country could change, prompting it to move new investment elsewhere. Several strategic considerations could motivate the relocation, such as increased competitive intensity at the original location, a cost-reduction requirement which encourages the search for new low-cost production locations, or pressure to enter new markets in response to similar moves by a rival. In the Asia region, the transformation of China's economy from a centrally planned to a market economy has changed the trends and patterns of investment among MNEs, particularly from emerging countries. Since the economic reform in 1979, foreign direct investment into China has increased dramatically. Inward FDI into China has grown at a compounded rate of 23.6 percent at the value of USD83 billion in 2007 (UNCTAD, 2009). MNEs from emerging countries are now turning their attention to this country, which offers an abundance of remunerative and rewarding resources. The increase of foreign direct investment in China has been attributed to various factors, including its market size, domestic market growth, slow transformation and integrated plan-driven and self-sufficient national economy that has moved smoothly into the global economy (Lardy, 1994; Naughton, 1995; OECD, 2002; Peng, 2003). MNEs from emerging countries, particularly from the East Asian region, view China as an investment location that offers abundant and cheap labor, plenty of raw materials, large and growing domestic markets, geographic proximity to Malaysia, special tax and other incentives and attractive development of export markets through preferential treatment. Most Malaysian firms are attracted by the low cost opportunities offered by China, which enable them to compete with industry rivals and maintain their competitiveness. These opportunities might not yet be viable in other locations in the region. The growth of investment in China has been growing rapidly following the close trade and government ties between the two countries. China

has now become an important investment destination for Malaysian companies seeking to secure a market to complement their manufacturing operation. The above reasons also explain why China has become the second largest recipient of foreign direct investment (FDI) in the world (Pan, 2003). Foreign direct investment in China has been increasing since the early 1990s and it has become a catalyst for the country's economy.

The theories discussed earlier, which include internationalization and the eclectic paradigm (Buckley, 1990; Buckley and Casson, 1976; Penrose, 1959; Dunning, 2003; Dunning, 2001) are useful to understand the choice of location for foreign investment in and across China (Wu and Strange, 2000; Luo and Tan, 1997). Regulatory changes and reforms have improved the location-specific advantages of China (Zhang, 1994). A prominent example is the establishment of special economic zones in selected coastal areas in the mid 1980s. This and local-bound endowments have led to FDI being clustered in certain areas. Head and Ries (1996) find that Chinese policies that supported the development of infrastructure and an industry base are positive determinants of city attractiveness for future FDI, and so generate more inward investment (Cheng and Kwan, 2000; Fung, Iizaka and Parker, 2002; Zhang, 2001). In addition, other important factors for MNEs investing in China are determinants of economic development and prosperity (Broadman and Sun, 1997; Coughlin and Segev, 2000), levels of education (Broadman and Sun, 1997; Fung et al., 2002; Zhang, 2001), wage costs (Cheng and Wan, 2000; Coughlin and Segev, 2000), the institutional environment and support in Chinese provinces (Zhang, 2001), and the coastal proximity of the province (Coughlin and Segev, 2000; Wei, Liu, Parker and Vaidya, 1999). These determinants are generally acknowledged and are consistent with the insights gained from empirical and conceptual studies for other countries (Dunning, 2001; Dunning and Lundan, 2008). Kogut and Singh (1988) and Tallman (1988) bring to light country-specific factors which are the macro-level environmental characteristics of the source and host countries that are presumed to affect firms' investment activities. These country-specific factors were examined by Pan (2003) on China, including exchange rate, cost of borrowing, size of source country, reliance of source country on external trade, risk conditions in the host country, closeness between the source and host countries and management orientation of the host country. His findings affirm that China offers country-specific factors which include the size of the source country, reliance on external trade, and managerial orientation to foreign investors, so these factors are able to influence MNEs coming into the country. The risk condition of China and closeness to the host country are not supported in his study. Generally, firms have invested into China in order to tap the large domestic market.

Dunning (1992) claims that types of FDI and stages of progress in the investing and recipient countries have a significant influence on the decision 'where' to produce. One of the most important factors in foreign investment is the political stability of the recipient country. China is fortunately not only stable in its politics, but also offers other advantages that attract firms to move into the country. The rapid growth of its economy, socio-cultural factors, government incentives, demographic structure and the vast market in China are strong enough to attract foreign investment into the country. Based on the stock of inward FDI, China has become the leader among all the developing nations and second among the APEC nations (Graham & Wada, 2001). The majority of FDI in China has stemmed from developing Asia, excluding Japan. Yang and Lee (2002) argue that the persuasive reasons for entering into China's market are obviously because of the cheap labor, a huge market and the chance to make a significant reduction in operating costs. It is worthwhile to close plants in more expensive locations and relocate the production to China. Economists divide the contributing factors of China's rapid economic growth into two main categories: large-scale capital investment (financed by large domestic savings and foreign investment) and rapid productivity growth. These two factors appear to have gone together hand in hand (Hu and Khan, 1997). Based on the above two economic growth factors, China can be considered as a strong economic country. These characteristics have made China an attractive destination and become one of the pulling factors that entice investors from all over the world, including Malaysia, to establish their businesses. This is strongly evidenced by Chinese trade data that portrays China as in the top five trading

partners in 2006, which include the European Union (EU), Hong Kong, the United States, Japan, and the ten nations of the Association of Southeast Asian Nations (ASEAN), including Malaysia.

As a country with a 1.3 billion population, the largest population in the world, China is divided into many regional centers consisting of more than 50 ethnic groups. Therefore, the country is affluent with a variety of cultures, traditions and value systems which have a significant impact on the business operations in the country. For example, the cities of Shenyang (in the northeastern Liaoning Province), Nanjing (in the eastern Jiangsu Province), and Xian (in the northwestern Shanxi Province) are known as political and cultural centers, while the cities of Shanghai, Tianjin, Guangzhou, and Wuhan are popular as business destinations (Yang, 2002). Foreign investors in China are classified into three major groups; firstly, investors from Hong Kong and China, who are mostly Chinese and share a similar culture; second are investors from East Asian countries including Malaysia, which has close cultural ties with the country due to its geographic proximity and historical links; and thirdly are investors from Western countries. Malaysian MNEs are more comfortable in building trust and relationship with their Chinese counterparts. The unique concept of *guanxi* networks, which can cultivate close personal relationships with business associates to earn their respect, has become one of the attractions of doing business with Chinese people (Woo and Prud'homme, 1999).

METHODOLOGY

This study examined the internationalization and outward foreign investment of MNEs from emerging countries by using a case study approach on a private Malaysian MNE that has chosen China as its investment location. The firm is known as Eng Technology Co Limited, and it was chosen to provide insights on the motives of outward foreign investment into China. Data was qualitatively analyzed using a distinct inquiry process that explores social or human problems in a natural setting in order to gain an in-depth understanding. This method gives insights into the situation of interest, which may not be possible using other types of research. As qualitative data is extremely varied in nature and includes almost any information that can be captured that is not statistical in nature, this study gathered and compiled the progress and development of the firm chosen in its strategies when investing in China. Data was gathered through direct observation and a collection of written documents which included company reports, newspapers, magazines, books, websites, transcripts of conversations, annual reports, and others. The contents of these documents were read, classified and analyzed in order to access the findings. The secondary sources used were in the form of published works such as journal articles and books, and also conference proceedings.

ENG TECHNOLOGY INTERNATIONAL EXPANSION

Eng Technology Private Company Limited (Engtek) is a Malaysian MNE which has successfully expanded into China. Engtek Group is a local Malaysian firm involved in precision engineering and manufacturing. It started operations in 1974 in Penang and has grown to be amongst the top precision engineering and manufacturing supply chain players for the electronics industry in the Asia Pacific region. In 2008 the group revenue was USD153 million. The headquarters is in Penang, Malaysia, where the company is supported by strong financial and human resource management systems. A progressive installation of state-of-the-art machinery has enabled the company to maximize productivity, efficiency and overall capacity utilization to satisfy the demands of the industry and a unique international customer base. Engtek Group has thrived to become a regional manufacturing powerhouse, a world-class global supplier of Hard Disk Drive (HDD) components and cost-competitive manufacturer. Among the key customers for Engtek are Hitachi (HDD), Hitachi Metals (HDD), IBM, JVC, Min Aik, Minebea (HDD), Mitsumi, Nidec, Samsung, Sauer Danfoss, Seagate(HDD), TDK, SAE (HDD), Totoku (HDD), Western Digital (HDD) and White Rodgers.

Engtek has received numerous awards for its achievement in the industry (www.engtek.com). Among them are: 1999 - Asiamoney's Poll: Best Small Managed Company in Malaysia, 2000 - HSBC 100: Asia's Leading Corporate Award, 2000 - Intel Supplier Recognition Award, 2001 - Distinguished Partner Award (from Fujitsu), 2001 - Forbes Global: World's Best Small Company, 2001, 2003 & 2004 - Outstanding Supplier Award (from Maxtor), 2002 - Best Local Vendor Award (in conjunction with the 30th Anniversary of the Electronics Industry in Penang), 2007 - Copeland (Sidney) Appreciation Award, 2007 - Emerson Marquee Supplier Award, 2007 - Emerson - Thailand Supplier Award and 2008 - Emerson Marquee Supplier Award

The success of the Engtek Group can be attributed to a few key factors. The Malaysian government's effort to promote growth of small and medium enterprises in the country is the primary factor. Other key contributing factors include the various incentives granted to Engtek's operating subsidiaries in the country and the availability of a skilled management and operating workforce. Malaysia is also a cost-competitive location for the regional headquarters, with an investment environment that effectively supports its business activities, which include regional sales and distribution, engineering and applied development, value-added manufacturing and corporate finance functions.

The Engtek Group currently comprises seven key operating subsidiaries, of which three are based in Malaysia, and one each in the Philippines, China, Singapore and Thailand (Annual Report, 2009). Engtek produces about 10 million pieces of HDD from its operations in these four countries. The Group has annual sales in excess of USD80 million and its cumulative investments over the years have exceeded USD67 million (Annual Report, 2008). During the country's economic boom in the 1990s, Engtek started to embark aggressively on international expansion. In 1996, it established Engtek International Limited in Dongguan, China. The following year, the company set up Engtek Philippines Inc, an international-based facility in Laguna, Philippines. In 1998, the company entered Thailand by establishing Engtek Precision Co Ltd to manage its exporting operations. In three consecutive years, the business expanded into three foreign countries. In 2003, the company moved ahead with its international expansion when it acquired Singapore Altum Precision, the first regional acquisition made by the company. In 2006, Engtek (Thailand) was upgraded into a manufacturing subsidiary in the industrial park in Ayutthaya, Thailand. So far, the company has invested between USD10 million and USD13 million for its venture in Thailand, which is seen as a strategic location due to its proximity to major clients like Western Digital and Seagate.

DRIVERS AND MOTIVES OF MALAYSIAN MNES IN CHINA

Engtek International Limited, the first offshore manufacturing plant, was established in Dongguan, China in 1996. The motive of its establishment was to explore potential markets, creating value for its international brand name and staying ahead of its competitors. It also aimed to gain benefits from the trend of globalization along with a national policy environment which is conducive to enterprise development. Dongguan was chosen due to several advantages including its location, government policy, demography, economy and technology. Dongguan is an important industrial city located in the Pearl River Delta, bordering the provincial capital of Guangzhou to the north, Huizhou to the northeast, Shenzhen to the south, and Foshan to the west of the People's Republic of China. The urban center of Dongguan is 50 km away from that of Guangzhou to its north, 90 km away from Shenzhen to its south, 47 sea miles away from Hong Kong and 48 sea miles from Macao by waterway.

The strategic location of Dongguan helped the firm's new offshore manufacturing plant gain a favorable geographic condition. The city has also placed an emphasis on investing in infrastructure to target more multinational corporations to become a region of technology. These geographic advantages contributed to lowering the costs of logistics and administration (MIDA News, 2007). Besides the location advantages, China's government policies were also attractive and persuaded Engtek to locate their investments in the country. The policies include preferential tax treatment, the freedom to import inputs,

easy licensing procedures, as well as the removal of many unnecessary local costs, and provided options other than joint ventures to balance foreign exchange. The policies were also designed to promote backward linkages which require a foreign investor to purchase a certain amount of intermediate input from local suppliers. In addition, as a computer hard disk drive and semiconductor manufacturer, Engtek Group enjoyed encouraging support from China, as it corresponded with the country's FDI policy of promoting technology transfer. Additional tax exemptions are also granted to export-oriented joint ventures and those who employ advanced technologies. These progressive policies fit well with most requirements defined by Engtek Group before the final decision to invest was made.

The economic condition of the country also played an important role in attracting Engtek Group to invest in China. The economic reform from a centrally planned system to a more market-oriented economy has enabled China to be actively involved in international trade and increase the growth of the private sector's economy. The rapid economic growth is driven by China's large-scale capital investment which is financed by large domestic savings and foreign investment from its major foreign investors from countries like the United States, Japan and Taiwan. The rapid productivity growth started with the reform of China in 1979. In addition, the prices of numerous goods and services are significantly lower in China than in other countries. These benefits are golden opportunities for Engtek, so the firm has endeavored to capitalize them through its investment strategies.

Several factors propelled Engtek to engage in FDI into China. These factors can be categorized into two types, locational factors and firm factors. Locational factors are attractive in pulling a firm into China, while firm factors are pressures that push a firm to accelerate expansion abroad. China, and specifically Dongguan, offers various locational advantages, as highlighted by Dunning. China is endowed with high economic growth, tax exemptions and other government incentives, good infrastructure, easy access to the ports, cheaper raw materials and low labor costs. These factors are incredibly lucrative for Engtek in sustaining its competitiveness. At the same time, Engtek faced various challenges in the local market, which urged the company to find alternative strategies. The relocation of its key customers into China compelled the company to pursue them to secure its market. As most of the key customers were relocating their manufacturing plants in China, Engtek took a similar step. Hence, the firm went abroad earlier than it intended. At that period also, the costs of labor and materials were continuing to rise, which caused the firm to lose its competitiveness as a major supplier to the major customers.

Engtek China has expanded its output to produce more than three million pieces of actuators per month since 2008. Besides manufacturing actuators, the Dongguan facility also performs value-added assembly work for actuators to enhance their competitive edge. The number of actuator manufacturers in China is increasing thereby intensifying the competition. The Dongguan plant also manufactures hydraulic components for industrial product companies. Key customers for hydraulic components are in Europe and the US. While the Thai operations focus on HDD for laptops, and low-end desktop and mobile devices, the Chinese plant concentrates on high-end storage and desk top computers.

Globalization forces the firm to respond swiftly to the rapidly changing market place. Engtek embarked on outward foreign investment after experiencing valuable learning and capabilities-building with foreign MNEs in Malaysia such as Seagate, Fujitsu, Toshiba, Western Digital and other global players for a certain period of time, through various types of alliances. The knowledge accumulated in the diverse backward linkages with advanced global firms was harnessed in its outward foreign investment strategy in China. Having a manufacturing plant in China also enabled Engtek to establish a network with local suppliers. Local procurement offers lower production costs and allows greater specialization and flexibility; as a result, technologies and products can be adapted better to the local conditions. Hence, the firm considers the network or relationships with local suppliers as a critical factor for success, as they facilitate managing international operations. The Malaysian government under the Mahathir administration also recognized the importance of outward foreign investment, so various incentives were

given to firms that were attempting to engage in foreign investment. Consequently, these factors become a driving force for the firm to invest in a foreign market and specifically into China. The above reasons pushed the firm to invest in China. Figure 1 summarizes the motives for Engtek to invest in China.

THEORETICAL AND MANAGERIAL IMPLICATIONS

The international expansion of Engtek can be described by internationalization theories and the eclectic paradigm. The international expansion of the firm into nearby countries like China fits into the Uppsala model, which describes how psychic distance plays a pivotal role in foreign expansion strategies. This strategy helps the firm reduce uncertainties and risks of failure in foreign markets. The firm's international expansion into China depicts its vertical and horizontal participation. China's comparative advantages as an investment destination indicate that Engtek experienced a vertical global expansion, while a horizontal global expansion can be seen when Engtek utilizes delivery facilities in China to exploit market opportunities. Engtek depicts an incremental process of internationalization, perhaps due to its capability as a medium-sized firm which relies heavily on transnational companies from developed countries as its key customers. Being in a business-to-business industry and a major supplier for global players, the dependency on major customers limits the firm's speed of international growth. Nevertheless, working closely with them through alliances and other formal relationships offered vast opportunities for Engtek to acquire knowledge. The learning process and experiences gained are significant in developing the firm's internal capabilities and exploiting the available tangible and intangible resources. Thus, the theory of the resource-based view can also help describe the international expansion of Engtek.

China is the most strategic location for Engtek obviously for the motivation of costs, which is referred to by Dunning as efficiency seeking. The costs of operations, raw material and labor are very much lower in China than Malaysia itself, so moving into this country is a necessity for the company. Maintaining product competitiveness through improved quality, technology and costs is the core reason for securing its market with the buyers. Engtek was also desperate to enter China, as it needed to be close to its customers, which indicates a market seeking motive. Proximity to customers or buyers enables the firm to satisfy the customers' need and accommodate to the changes required. Engtek is involved only in downstream activities, selling and servicing the customers. Therefore, it is crucial for the company to create backward linkages for sources of raw materials and forward linkages to protect the market and reduce uncertainties. In the quest for efficiency, the backward linkages have enabled Engtek to exploit its resources, such as human capital and technology, and to harness China's low cost factors, such as cheaper raw materials and labor. Having a business operation in China also enables the firm to avoid restrictions imposed by the China and Malaysia itself in the local market. The buyer-supplier relationship is the major motive for the firm to expand its international operations in China. Thus, the firm engages in both vertical and horizontal international expansion.

CONCLUSION

The emergence of China with abundant and low-cost resources has lured MNEs from emerging economies to engage in outward foreign investment. The advantages offered by the country have attracted firms from Malaysia and other parts of the world to be there to reap the benefits. Engtek, a medium-sized firm from an emerging country, has adopted a bold strategy in expanding its business operations into a foreign country. China is the first and largest country that the company has invested in due to the attractive package that the country offers. Despite its smaller size relative to typical MNEs, the firm has managed quite well its foreign direct investment in China and generated considerable revenue for the company. The internationalization of the firm is gradual due to the constraints of its financial and technological capabilities, yet the foreign investment is mandatory to maintain its close relationships with the major customers. Apparently, Engtek moved into China mainly for efficiency and market reasons. Efficiency seeking enabled the firm to lower its operating costs, thus creating its competitive advantage

over rivals, while market seeking allowed it to be closer to its customers and serve them better. The downstream activities in which the firm has completely engaged require it to exploit the advantages of the investment location and harness its internal capabilities. Only by doing so can the firm learn further and enhance its capabilities in order to maintain its competitiveness in the industry. Overall, this case study depicts further evidence pertaining to the international expansion of MNEs from emerging countries like Malaysia. Internationalization models such as the Uppsala and Dunning motives correspond well with the phenomenon of the medium-sized firms from emerging countries.

Figure 1: Motives for Engtek’s OFDI into China

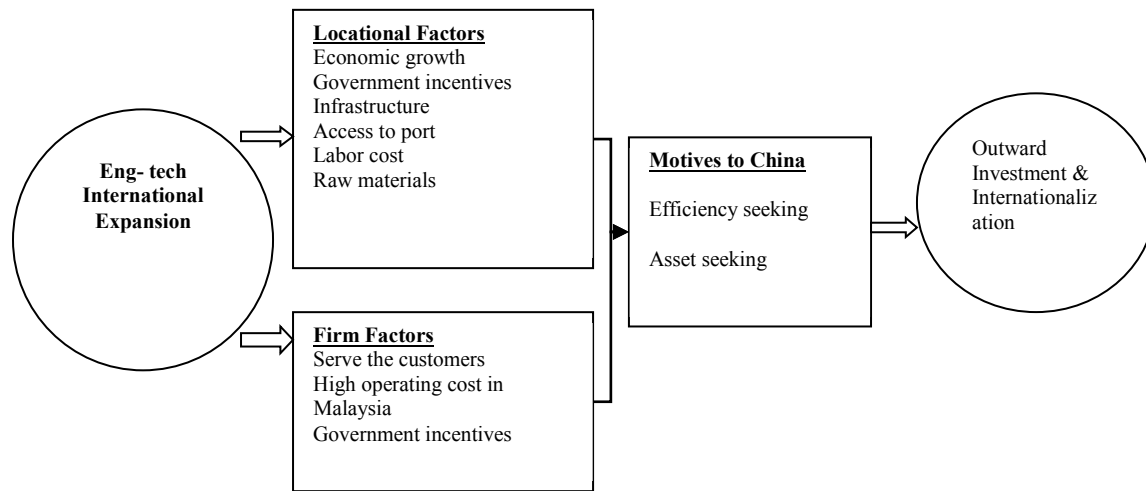


Figure 1 portrays a framework for Engtek in its international expansion that has been inferred from the findings of the study. Engtek expanded to China based on two major factors: the locational advantages that China offers as a pull factor and the firm factors as a push factor that forced the firm to invest in China. Serving customers who had relocated their plants in China forced the firm to move close to them and cost-saving also triggered them to be in China.

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FOREIGN DIRECT INVESTMENT IN AFRICA: SECURING CHINESE INVESTMENT FOR LASTING DEVELOPMENT, THE CASE OF WEST AFRICA

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ABSTRACT

At the end of the 20th century, when investors were actively seeking a favorable and secure place for their capital investment, the African continent rarely crossed their minds. Recent misgivings experienced by financial markets around the world and the increased demand of natural supplies forced investors to focus on Africa. This circumstance, for over a decade, has put all Africa, including both developed and industrialized countries in an embarrassing position with very low foreign investment. It is not possible to discuss Africa's development without referring to the current Chinese investment in Africa. In the past twenty years, China's interest in Africa has grown significantly. This has simultaneously aroused intense debates within the international community because it has the ambition to set up long-term partnerships with African countries. This new state of affairs will inevitably create legal protection problems for the interests of each party. This article examined the impact of China's investment on African countries development. We examine how Chinese investors face challenges in Africa and what legal protection the host country provides to the investors to secure their profit and at the same time protect their own interest.

JEL: F21, K33, P33

KEYWORDS: Foreign Direct Investment, Foreign Protection of International Investment, Developing Countries and Regional Integration

INTRODUCTION

Historical evidence shows the African continent has attracted the attention of foreign investors, actively seeking a favorable and secure place for their capital investment. The fundamental reason was the legal and judicial insecurity that prevailed in Africa after the 1960's. But, the most recent demand for natural supplies have increased attention on Africa. For over a decade Africa has been in an embarrassing position with low foreign investment. It is not possible to discuss Africa's development without referring to Chinese investment in Africa. China has become the leading country on foreign direct investment in Africa. For the last two decades, China's interest in Africa has grown exponentially, resulting in debates within the international community. It has a noble ambition to set up long term relationships with its African partners. But China is not a new player in Africa, since it has invested in African countries before events such as Sudan in 1994 (Pierre-Antoine B. 2006). But during that time, the investment was low and protection was not a serious issue. The new state of affairs will inevitably create a legal protection problem for each party because foreign investment is subjected to the law and administrative control of the host country and it therefore means guarantees offered to foreign investors must not risk the States' right to legitimate rule.

This study focused on West Africa due to the recent evolution of Chinese companies' presence in West Africa, the rapid development of its Foreign Direct Investment (FDI) in the region. And, especially because of strong desire of the State Members of the Economic Community of West African States (ECOWAS) to successfully integrate the region and harmonize the ECOWAS Investment policies.

Recent, Chinese investment has been increasing in West Africa due to the presence of material supplies; and the procedure of harmonizing investment policies in the region into a single code, adopted on June 2008 by the Authority of the Head of States, to simplify the investment regulatory regime by the West African States. But investors are facing some constraints including cultural issues and the failure of the investment climate which is not conducive for investment in the region.

The purpose of this paper is to examine and explore the increasingly important economic impact of the Chinese FDI on West African countries development. It will also seek to examine how Chinese investors face challenges in Africa and what legal protection the host country can provide to its foreign investors to secure their profit and at the same time protect its own interest.

China's economic growth is causing China to increase its investment activities in Africa to make it more relevant to African countries. It has become a new lender for African countries. This position is not determinable by the duration of its presence on the continent, but the exploding increase in amounts lent to African countries and by its importance as a lender outside the existing dominance of development western actors. There are needs to protect its investments to allow continuity of foreign direct investment. This paper will review the evolution of Chinese Foreign Direct Investment in Africa by identifying the model of Chinese partnership with Africa, the prospects for China's role in developing Africa's infrastructure within the context of China's new trend investment engagement in Africa. We also analyze the various obstacles and challenges faced by Chinese investors, and finally the establishment of laws and rule of the investment policy in the regional integration organization to improve, increase and protect foreign investment as well as Chinese investment in the region.

The study will proceed as follows. The first part introduces our work. In the second part, we present a literature review of the sino-african partnership. The third section discusses Chinese FDI in Africa through the new trends of Chinese FDI in Africa. The fourth section focused on various risks for investment in Africa and their effects on the development. In section five, we underline the opportunities of economic development by securing Chinese's direct investment in the continent. This part of the work also focuses on the improvement of the local laws to attract more significant foreign direct investors in particular in West Africa. Finally, section six concludes the work.

LITERATURE REVIEW

The literature has concentrated on identification of drivers of Chinese investors in Africa, the rapid growth of sino-african relationship, the potential impact of Chinese outward FDI of African continent development. Historically, China has had a long economic and political relationship with African countries which goes as far back as 500 years old (Mohan and Kale, 2007). Since 1990, the forces unleashed by the China Open Door Policy of 1979 created a significant momentum in China's interest in the mainland continent (Shola Oyewole, 2007). The recent note of African Development Bank report named "China and Africa: An Emerging Partnership for Development?" shows that in 2008, sino-african trade reached \$114 billion (Schier R., 2011). This study focuses on the relationship from a post-financial crisis viewpoint; outlines details of both China's trade with Africa and its foreign direct investment into the continent; reviews China's manufacturing and industrialization policy in Africa; looks at China's aid and assistance program in the continent; discusses Chinese infrastructure investments and their implications for African regional integration; and finally analyzes the China-Africa relationship in the context of international aid architecture. It notes that Chinese competition could threaten African countries that export manufactured products and also notes that unlike western donors, China has a different perspective on the encouragement of good governance in Africa.

China's contemporary policy for Africa is to focus on few factors that are important, such as its need for energy security driven by its domestic development strategy; new market and investment opportunity to

establish export markets for its light manufacturing, services, agro-processing, apparel and communication offerings; diplomatic and development support for its The one-China principle; and forging partnership strategic (Konings P. 2007).

Regarding the Post-crisis prospects for China-Africa relations, Jing, G. and Richard S. (2011), noted that the global crisis did not appear to dent China's enthusiasm for investing in Africa and "surveys undertaken in early 2009 in Beijing indicate that entrepreneurs would continue to invest in, and trade more, with Africa". The authors pointed out the rapid reduction of Chinese export to Europe and American markets led to finding new markets, such as in Africa.

For some researchers, Africa's economic growth has been predicated on higher commodity prices while diversification into manufactured production has been limited (Mary-Françoise, R. 2011). In her study, Mary-Francoise (2011) pointed out the lack of African success in manufacturing compared to Asia. The only problem according to her, is that Africa's economic policies as well as governance and institutions have been far weaker than in many of the successful Asian economies (see Table 1).

Promoting the investment climate in Africa needs a clear view of the proper role of the public and private sectors in economic development. African countries can reduce risk through macroeconomic stability. This means that inflation has to be controlled, exchange rates stabilized and interest rates set at realistic levels. Government action needed to introduce fundamental changes in the macroeconomic environment, stimulate local private and foreign direct investment through the removal of distortions in the incentive structure and to encourage a more efficient allocation of resources and factor inputs in line with supplies endowment and national development objectives (Karamo N.M. S. 1994).

The structure of Chinese Infrastructure Investments and African Regional Integration was drawn to the attention of Richard S. and Alex R. in 2011, who both underline the importance of regional integration if Africa is to reap the benefits of economies of scale, access to globalized markets and strengthen its position in international negotiations. Their work underlines the importance of China trading and dealing with Africa's various regional trading and economic groupings such as the Economic Community of West African States (ECOWAS), the Common Market of Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC), and notes that such regional trade has been growing over recent years.

The legal protection of international foreign investments by states is one key instrument and an important mechanism to ensure the sustainable economic development in African countries (Charles Edward M. 2007). Other authors also explained how International direct investments can promote sustainable economic development, and the state of effective legal protection of international investments in ECOWAS countries (Gilbert A. and Falou S. 2008). Gilbert and Falou's study argues that African countries in the Western region have so far made commendable efforts to reform their legal and institutional frameworks for promoting investments. The legal, business and economic environment for FDI in West Africa and the protection of FDI is regulated at various levels, by international agreements or treaties, West African regional agreements and national codes or legislation of each State member of ECOWAS.

THE TRENDS OF CHINESE FOREIGN DIRECT INVESTMENT IN AFRICA

The last two decades, saw China rapidly becoming an important source of outward foreign direct investment. The recent profound increase has made an important change in Chinese foreign investment policy as well as in the world economy and geopolitical competition (Mary-Françoise R., 2011). The landmark Bonding Asia-Africa conference in 1955, is seen as the foundation stone of Sino-African modern partnership. Despite some important economic projects, the cooperation between 1955 and the

mid 1990's was mainly political. But the important period of their relations started when Chinese Government policy was the main determinant of outward foreign direct investment. Most Chinese companies have been moved into African countries in the last 5 years. In the context of China's growing role as an investor in Africa, concerns over China's investment behavior are being raised and Chinese enterprises are under increasing pressure to be more responsible global players and the Government has encouraged such efforts. According to Mary-Françoise R., China's development philosophy must serve as a model for Africa and an alternative source of trade and finance from Africa's traditional development partners. China's involvement with Africa goes beyond trade and investment and includes development assistance (Schiere R., 2011). Our purpose is to establish the Chinese model as a harbinger of a new international economic regime or a continuation of old ideas with a more modern extent.

China's Presence in Africa: a New Economic Partner for Africa's Development

Africa is the world's second-largest and second-most populated continent after Asia. It comprises of 54 independent countries with many cultures, diverse customs and languages; but it is also known to be the world's poorest continent despite its natural resources. China's interest in trade and investment with Africa, home to over one billion of the globe's poorest people and the world's most formidable development challenge, presents a significant opportunity for growth and integration of the Sub-Saharan continent into the global economy (CIAWF, 2009). China is not a new player in the African continent, and its economic and political presence, also its impact has grown exponentially in the last few years. This implies that African countries face a lot of new challenges for China's role in their continent. Like other parts of the world, Africa is very much affected by the phenomenal growth of the Chinese economy. In the view of China's aid strategy in Africa, the main motive for its partnership with African countries is to gain access to the abundant raw materials of Africa. Alden, C in 2005, pointed out that the good reason and important requirement of Chinese presence in Africa is China's insistence on recognition of its one China policy by African States. This is the political foundation principle, which governs its establishment and development relations with African countries and regional organizations. In its main co-operation driver's way, "China will continue to strengthen solidarity and cooperation with African countries in the international arena, conduct regular exchange of views, co-ordinate positions on major international and regional issues and stand for mutual support on major issues concerning state sovereignty, territorial integrity...."

China is the world's second largest consumer of oil and energy, with its limited natural resources, its dynamic economic growth fuels an ever-increasing need for energy and strategic minerals. Africa is the best place to get these resources. China's attraction to Africa's relatively under-exploited petroleum and other natural resources can be traced back to 1993, when it changed its policy from a net exporter to a net importer of oil (Joshua E. and Joshua R., 2003). Sudan was the first African country to receive Chinese investment for oil in 1994 (Pierre-Antoine B., 2006). Ten years later, China was consuming 5,460,000 barrels a day (bbl/d), outstripping Japan's 5,430,000 bbl/d but still some distance from the United States's 19,700,000 bbl/d (Erica D., 2004). Investigation reports show that Chinese interest in Africa is for the foray of the continent's energy business.

Another important reason for Chinese presence in Africa is economic interest (Akinlo, A. E. 2003), which aims to establish a new market and investment opportunities. Despite the small consumers market for African goods, the Africa trade relationship with China has had a significant impact on African economic growth and development.

China has been able to find a market for low-value consumer goods brought in by Chinese-dominated import companies and sold through a growing informal network of trading posts across urban and rural Africa. "Chinese products are well suited to the African market. At the time, China is in a position to make basic products at very low prices and of satisfactory quality." (Zhou Z. 2004) Chinese private

companies are actively investing in Africa by flexible and diversified means. The number of private enterprises investing in Africa accounts for more than 70 % of the total number of foreign enterprises investing in Africa. In the last decade, there are officially 820 Chinese enterprises (He W., 2006) being established in Africa and the trade volume between Africa and China is more than €29 billion (Nathalie F., 2006). China is now the third commercial partner of Africa since 2005. Its growing population and energy demand is pushing it to forge joint-partnerships with several African states rich in natural resources where China invests capital and develops the country's infrastructure in exchange for employment and favorable terms for extracting raw materials to China (Chen D., 2011). China has started and increased agricultural co-operation and investment with Africa in trade and other commercial activities since 2000. With the Government encouragement and the recent challenge of climate change, Chinese agricultural investment in Africa has developed against a backdrop of closer economic ties with the continent. Chinese investors have also established, in the textile and agro-industries, joint ventures that aim to export goods to the West at concessional rates by using the special provisions of the United States' African Growth and Opportunity Act (AGOA) and the European Union's Continual Agreement.

During the radical revolution movement period (1966-76) which saw China's youths lose a generation of education, a slow economic production and trade, virtually severed China's relations with the rest of the world as well as Africa (Mary-Françoise R., 2011). As a result China's desire to be an economic power was set back significantly. This situation has made a critical change in the China's foreign policies and led it to open the trade relations with the West. Since then, it started playing an active role in international organizations, and diplomatic relations were established with countries willing to recognize the People's Republic as the government of China rather than the Nationalist government on Taiwan. On January 1st, 1979 China's full diplomacy was recognized to the detriment of Taiwan. China's insistence on recognition of its One-China policy by African countries has forced it to provide aid and investment to the mainland. Its economy has become the fastest growing economy in the world (in spite of not having changed its communist political stance), which has been aided by access to cheap resources in Africa. In examining the relationship-change over time, what is China's strategy to increase its investment in Africa?

Chinese Investment Model in Africa

Many factors have made China and Africa's relationship distinct, compared to the West's relationship with Africa. China kept an active menu of aid projects in more than forty-five African countries and its investment assistance to Africa in the form of building infrastructure boasts a long history. The Chinese model of investment in the continent brings in essence economic growth objectives and foreign policy, together guiding trade and investment decisions in Africa along with zero or near-zero percent interest financial and technical assistance. Chinese bid competitively for resource and construction projects using investment and infrastructure loans (Zafar A., 2007). Many Africans view Chinese investment in the continent as different from western investment. The neo-liberalism reform usually required by the World Bank under its conditional provision does not affect the Chinese investment model in which aid comes without strings attached. China is having a profound impact on African economies by building a network of trade, aid and investment and some important infrastructures with close to fifty countries. Chinese investment in Africa is not only beneficial to the Africans, but also to the Europeans and the Americans. China's investment are modeled by financing development projects in Africa as direct investment has very little interest for the West. In order to grow, African economies need some important infrastructure as well as Chinese investment, which can help these African countries build roads, railways, hospitals and schools concluded the author. In Africa, China is playing an important role by financing and providing much expertise needed by the continent. The main trends of Chinese investment in Africa are as follows.

Firstly, Chinese Foreign Direct Investment structure which is based on the noble purpose to establish long term relationships with African governments is very different from Western countries model which is to involve private investors and does not undertake a long-term presence in the continent. Secondly,

Chinese investment encourages the development of infrastructure in Africa. Thirdly, infrastructure must be improved to facilitate the access of the African products to regional and international markets. Africa's exports to China are increasing, while trade between the other major continental markets and Africa is stagnated. Fourthly, Africa's imports from China actually are more diversified than its exports. There are three main types of products imported: machinery and transport equipment; manufactured goods and handicrafts products for improving local consumption and which has contributed to the emergence of a consumer society in Africa. And finally, the creation of special economic zones exploited by the Chinese in African countries since 2006 should focus on value-added manufacturing by building the capacity of many African countries.

Africa still has challenges in its relations with China. But its rush to become competitive impacts the domestic manufacturers of some countries with squeezed China-sourced imports. However, it is consistent with China's policy as well as the country's goal to lessen its strain on its energy resources and to locate markets for its goods.

New Trend of Chinese Investment in Africa

Africa provides China with a good opportunity to secure a sustainable access to raw materials which are necessary for its growth. Africa is now a laboratory for Chinese manufactured goods. The breakthrough of the Chinese presence in Africa follows four phases: firstly the oil, then minerals, and construction, and finally exports with private operators, which is not necessarily related to the state apparatus. The fourth and last aspect constitutes the focal point of the trend of the new Chinese investment model in Africa. Recent developments in the Chinese presence on the continent focused on investments in the private sector and SMEs. With the Chinese government encouragement policy Going out, many private companies have turned to Africa in recent years. In terms of the number of projects, the vast majority are not in natural resources areas. These investments provide favor to the business model and distribution that promotes not only easier access of foreign companies, but also promotes and supports local economic development. The majority of Chinese enterprises in Africa are private companies. There are five factors leading them to invest and operate in Africa: the first one concerns the access to local market. The second one is the intense competition in domestic markets. The third is the transfer abroad of domestic excessive production ability. The fourth is the entry into new foreign markets via exports from host and the fifth one is its ambition for taking advantage of African regional or international trade agreements.

Chinese enterprises are less risky than their Western counterparts. They are not subject to the same social and environmental safeguards. Most Africans are welcoming Chinese investment and products. The history of traditional Western aid and investment in Africa is one of a nagging "I correct you because I want what's best for you" parental-like stronghold over the continent. Tired of "the politically motivated, finger-wagging approach of western governments," Africans have welcomed China's emphasis on pure business. Some of the key areas of Chinese investment, which align with improving the efficiency of resource extraction, are telecommunications, energy and physical infrastructure. These areas have traditionally been ignored by donors in Africa, who have instead favored social development programs such as education and health. Chinese companies are using some countries for its re-exports, particularly in the textile industries.

Reasons for Investing in Africa

As mentioned above, the primary evidence of the Chinese private investment in Africa resulted from both domestic and general reasons. Since 1990, China had started an economic restructuring with recognizing the need to upgrade its manufacturing capacity for increasing its international competitiveness (Cai C., 2006). The success of this economic restructuring policy led many new entrants into the market. But the inability to find sufficient domestic consumption created excess production capacity and led many firms

to look to establish operations overseas in new less challenging markets. On the other hand, because both China and Africa are developing countries, Chinese private companies feel comfortable in investing in Africa (Cai C., 2006) and the commercial opportunities in Africa are profound. Also, the introduction by the US government in the late 1990s of preferential textile quotas for Africa encouraged some Chinese firms to establish operations in African countries to exploit this opportunity.

INVESTMENT RISK IN AFRICA

Risk is the potential that a chosen action or activity will lead to a loss. A common definition for investment risk is deviation from an expected outcome. The notion implies that a choice having an influence on the outcome exists. Potential losses themselves may also be called "risks". Almost any human endeavor carries some risk, but some are much more risky than others. People invest money to earn a return on their money, but often they receive less than expected—indeed, sometimes the return can be negative, when the investor receives less than the initial investment. With some investments, the entire investment can be lost. Investment risk is the chance that you will receive less than expected return from an investment, and differs according to the type of investment. There are many types of risk that are caused by different factors, or which affect different investments to varying extents. Some factors affect most investments and are called systematic risks. Other risks, such as sector risks affect only a particular sector of the economy. Some risks are specific to a business or asset, and are called nonsystematic risks, or diversifiable risks, because such risks can be lowered by diversified investments. In general, the more active the investment strategy, the more an investor will need to pay for exposure to that strategy.

When investors are looking for a good profit, they also think about the potential risk associated with their investment in the host country. It is well known that investors make decisions based on a function that includes the rate of return and the risk of any investment choice: the higher the risk, the higher the required rate of return (Benno N., Lopamudra C., Lebohang L., Vijaya R., and Jerome W., 2007). Each investment carries its own particular risk-return ratios. However, in Africa, a number of environmental factors, external to the individual investment, tend to raise the risk, and thus, for any given rate of return, reduce the rate of investment. The African continent is considered as a high-risk place for investment and there are a few reasons supporting this statement according to our understanding:

Political Instability

Most of the African region is politically unstable because of the high incidence of wars, frequent military interventions in politics, and religious and ethnic conflicts. Apart from Ethiopia, Liberia and South Africa, the other African countries came to political independence later and more rapidly than those of other developing regions. The historical political evolution of sub-Saharan African countries proved that in 1966 the average independent state in Africa had held sovereignty for 10 years less; its counterparts in the rest of the developing world had been independent for the better part of a century. Colonial structures of political control were both arbitrary and effective because of the boundaries cutting across historical patterns of politics and trade routes. This has contributed greatly to the various regional conflicts on the continent between neighboring nations, wars often tribal, ethnic, etc.

There is some evidence that the probability of war is very high in the region (Rogoff K., and Reinhart C., 2003). In their recent study, Rogoff and Reinhard had worked out the regional susceptibility to war indices for the period 1960-2001 and found that wars are more likely to occur in Africa than in other regions. Their study also pointed out that there is a negative statistically significant correlation between FDI and conflicts in Africa.

Benno Ndulu with Lopamudra Chakraborti, Lebohang Lijane, Vijaya Ramachandran, and Jerome Wolgin also argued that in the last two decades or so, Africa has experienced a debilitating descent of states into

persistent internal conflict that has become an all-too-familiar phenomenon across the region. In fact, conflicts are now arguable the single most important determinant of poverty in Africa. Conflicts affect the economy through reduced investment in both physical and human capital, as well as through the destruction of existing assets, including institutional capacity, and these are reflected in reduced economic growth.

The incidence and severity of conflicts in Africa have had a robust, negative effect on the growth rate of income. The evidence showed that the countries that experienced civil wars had an average income of 50% lower than that of countries that experienced no civil war, and sometimes, the indirect cost of the war could be higher than the direct cost because conflicts have always caused serious reversals in health and other human development aspects. As we see, political stability is one of the most important determinants of Foreign Direct Investment in Africa.

Macroeconomic Instability

Despite the fact that the macroeconomic stability has been achieved in most African countries now (low inflation, low public deficits), the investment environment is still uncertain because investing in Africa is still riskier than doing so elsewhere (Collier P., 2000). The lack of macroeconomic stability, evidenced by the high incidence of currency crashes, double digit inflation and excessive budget deficits, has also limited the region's ability to attract foreign investment. The risk in business, implies more profitable opportunities (Bigsten, & al. 1999b). There is no doubt that firms' investments are very low in Africa, pointing to other forms of uncertainties (political, rule, contractual, infrastructure). Investment and growth are higher in more stable countries in Africa and more recent evidence based on African data suggests that countries with high inflation tend to attract less Foreign Direct Investment (Onuyeiwu S., and Shrestha H., 2004).

Lack of Policy Transparency

In most sub-Saharan African countries, it is not easy to accurately identify the specific aspects of government policy because of the political regime changes in several countries. Regional policy changes and lack of transparency in macroeconomic policy are also problematic. The consequence of the lack of transparency in economic policy in a country is increases in transaction costs due to strict regulation while reducing the incentives for foreign investment. In Africa, the situation is one of concern and needs to be contained.

China's lending is generally suitable for Africa and often help to finance infrastructure and other projects which are the main needs of African countries. Unfortunately, we see that that China more willingly lends to countries that have large outstanding debts or that are rich in resources. This increases the risk to debt sustainability of poor countries and lack of transparency in the process of negotiating loans with China. The loan agreements between China and African countries are also not open to the public. This leaves a lot of power in the hands of a few African leaders and taints the process of transparency. The lack of transparency makes the conditions and the assessment of debts difficult. It also increases the risk that funds will not be used as intended and might be cases of illegitimate debt in the future. The lack of a favorable investment climate also contributed to the low FDI trend observed in the region. In the past, domestic investment policies were not conducive to the attraction of FDI. But since 1980, intensive efforts have been directed at generating economic recovery in West Africa. Much attention has been given to the need to promote investment because investment is essential in all West African countries to promote regional integration.

Information Imperfections

If investment projects with high social returns exist in Africa, securing financing for them requires overcoming informational frictions. We trust that investment projects with high social returns exist in Africa and socially productive investment opportunities also exist on the continent, but it is not sufficient. The securing financing for them requires overcoming informational frictions. It is also necessary that potential external creditors be aware of such opportunities. Frictions are the most important variables explaining the geographic distribution of cross-border equity flows. The information-related variables explain a large share of the variance in the allocation of cross-border equity flows, with countries from which information flows freely receiving larger flows than those that are relatively more opaque. Informational frictions play also a prominent role in the literature on home bias in the allocation of financial portfolios, as well as in the analysis of herding and catching in international capital markets. Information costs have also been cited to help explain why investors holding highly diversified international portfolios tend to react aggressively to “news” in the form of market rumors. Informational frictions may help to explain why international lending by banks tends to have a regional bias. The information costs may represent an independent obstacle to investment in Africa. Informational frictions may be particularly severe in the case of Africa because of distance, isolation and poverty. The effects of distance and isolation are self-evident.

High Protectionism

The low integration of Africa into the global economy as well as the high degree of barriers to trade and foreign investment have been identified as a constraint to boosting Foreign Direct Investment (FDI) in the region. The relationship between openness and FDI flows to Africa must be very positive and suitable to the continent. There are also other factors that contribute to the low FDI flows to the region such as the high dependence on commodities, the intensification of competition due to globalization which has made an already bad situation worse in Africa. Globalization has led to an increase in competition for FDI among developing countries. Weak law enforcement stemming from corruption and the lack of a credible mechanism for the protection of property rights are possible deterrents to FDI in the region. Foreign investors always prefer to make investments in countries with an effective legal and judicial system to guarantee the security of their investments. Investors can choose globally where to put their money and countries shouldn't make it too difficult for foreign investors if they want to benefit from that money. Sometimes, the African governments stifle investment by their regulatory policy whereas companies can only invest in big projects in countries where there is certainty and security for their profits and operations.

Africa has incredible potential. While capital flows have occurred quite successfully elsewhere, most notably in Asia, Africa has left behind. Despite Africa's enormous potential, low cost labor and vast natural resources, investors, quite frankly, remain reserved. They are afraid of putting their money in a place, which is often perceived as a continent affected by war, famine, AIDS, and corruption. Although specific financial mechanisms are necessary, they cannot address all the risks that confront businesses in Africa. Like everyone, Chinese investors also are facing all these challenges in Africa.

Sino-African trade has continued to grow at an exponential rate, with China displacing the UK as Africa's third largest trading partner behind the US and France. China accounts for nearly 20 per cent of Africa's total exports and more than half of Africa's exports to Asia. Across the continent, the Chinese are multiplying investments in infrastructure, telecommunications and agro-businesses.

The uncertainty of the business environment in Africa and the fact that all or part of the investment costs is "sunk", the Chinese investor may also, like all traditional investors, adopt a "wait and see" attitude. To avoid this situation at a time when the African continent need to raise the level of development, African

countries need to innovate in the field of legislation and regulation of investment policies in order to make the business environment conducive.

Table 1: African Governments Stifle Investment

How Much It Costs to Build a Company				
Some selected West African countries	Number of procedures	Time requested (days)	% of cost income	% of the minimum capital for income
Benin	9	63	189.2	377.6
Burkina Faso	15	136	325.2	652.2
Cote d'Ivoire	10	77	143.1	235.2
Mauritania	11	73	109.7	896.7
Niger	11	27	446.6	844
Senegal	9	58	123.6	296.1
Some selected Asian countries				
Korean Republic	12	33	17.9	402.5
Malaysia	8	31	27.1	0
Singapour	7	8	1.2	0
Thailand	9	42	7.3	0

The table above shows the selected West Africa countries with some challenges that foreign companies may have to face for investment or start business in these selected countries. Source: <http://rru.worldbank.org/DoingBusiness/default.aspx>

LEGAL PROTECTION OF INVESTMENT IN WEST AFRICA

The provision of a legal protection to improve Chinese investment in West Africa must be a new challenge for this economic West African region. China has pledged continuing development assistance and government-backed Foreign Direct Investment to African countries. It pledged to double its investment in Africa by 2009 and to give Africa \$2 billion in preferential buyers' credits over the next three years. Chinese investment in West Africa has focused on two main areas: infrastructure and human development. Chinese aid provides funding for highly visible and to many minds, important infrastructure projects, which Western donors have long since stopped financing.

ECOWAS Investment Policy Framework

Investment policy framework is a tool, providing a checklist of issues in policy domains for consideration by any national/regional government interested in creating an environment that is attractive to all investors and in enhancing the development benefits of investment to society. Considered one of the pillars of the African Economic Community, the Economic Community of West African States (ECOWAS) is a regional integration organization, which founded in order to achieve "collective self-sufficiency" for its member states by creating a single large trading bloc through an economic and trading union. The ECOWAS consists of two institutions to implement policies, the ECOWAS Secretariat and the ECOWAS Bank for Investment and Development, formerly known as the Fund for Cooperation until it renamed in 2001. The region is a vast area of 5.1 million square kilometers with an estimated population of 300 million; its huge unharnessed water resources, arable land and large market make it an attractive place for investors. Therefore, it is a good place for Chinese investments and it has to provide a security panel for these investments. The Foreign Direct Investment is one of the flashpoints of negotiations on the Economic Partnership Agreements context with the European Union.

There are a number of actions that ECOWAS countries might take at the international level to help attract greater flows of Foreign Direct Investment. These are solely focused on attracting investment, and have little to do with assuring the quality of the investment, or helping ensure that it fosters sustainable development in countries. These options involve signing some sort of international treaty committing to certain types of treatment for investors.

Investment policy framework gives a list of questions under each theme to encourage policy makers to ask appropriate questions about their economy, their institutions and their policy settings and to help governments determine whether their policies are likely to encourage or discourage investment.

In the last two decades, the community Member States have become more determined to address the problem of low investment inflows into the region. The Economic Community of West African States has become more accommodating toward foreign direct investment as evidenced by changes in the regulatory regimes of most of the countries towards overseas investors and their investments.

As mentioned above, foreign investment is governed primarily by national law of the host state and this economic integration community is expected to provide a single economic space in which business and labor operate in order to stimulate great productive efficiency, higher levels of domestic and foreign investment, increased employment and growth of intra-regional trade and extra-regional exports. Recently, most countries in West Africa, in appreciation of the impact of the regional investment climate on national fortunes, have begun to adopt policies that improve their investment climate. The quality of investment policies directly influences the decisions of domestic and foreign investors. Transparency, property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all.

Investment Policy Principles under ECOWAS

The West Africa regional community has adopted some important elements of a more coherent and comprehensive policy framework of investment, including the following. The reviews of its policies and rules affecting investment and private sector development with a view to improving the investment climate in their individual countries; a greater adherence to relevant rules and instruments on Corporate Governance; the reviews of costs and benefits of investment incentives and exchange views and experience on their use and economic impact; intensified actions to remove obstacles to business development, in particular regulations and administrative practices that obstruct or delay investment; a greater emphasis on partnership in building human capacities and skills necessary for acquiring and spreading the benefits of investment in the region; some efforts and initiatives to develop a framework for the competitive functioning of their markets which would include effective competition laws and the reform of economic regulations; some initiatives to strengthen the capacities of investment promotion agencies to disseminate information and to provide services to investors and encourage co-operation among these agencies at regional and international levels; some programs and projects to support small and medium sized enterprises and encourage their co-operation in regional projects; and consultations between business groups, private sector associations, social partners and civil society organizations to explore the development of investment opportunities and to provide input to the decision making process on investment policies, laws and regulations.

The investment policy must set laws and regulation to focus on issues as property and contractual rights, including intellectual property rights; the equal treatment of both foreign and national firms; removing the administrative obstacles to investment and Cost-benefit assessment of investment incentives.

Investment Security in West Africa

For many observers, the capacity of African countries to attract foreign direct investment is principally determined by their natural resources and the size of their local markets. The apparent lack of interest of foreign multinationals in African countries that have attempted to implement policy reforms support this argument. The continent has been much less favored than Asia and Latin America over the past decade in attracting Foreign Direct Investment. It has been argued that the reforms in many African countries have been incomplete and thus have not fully convinced foreign investors to develop activities that are not

dependent on natural resources and aimed at regional and global markets. It takes time for a country to modify its image, especially when the State has a long tradition of policy intervention, and when the reforms have been mostly symbolic with the adoption of new texts. As market size and access to natural resources are crucial determinants in the foreign multinational decision processes, so is the investment security important.

The successful European integration model has considerable attraction and impact as an example for many other regional agreements like ECOWAS (Gilbert A., Falou S., 2008). EU is assisting ECOWAS in its harmonization of its various national investment policies into a regional policy. Some established arrangements in the ECOWAS region have already provided framework of legal and regulatory for investments within the Community to operate, in order to access economies of scale in preparation to compete at multilateral level. To secure the Chinese investments in West Africa, it is now necessary to harmonize national laws of ECOWAS member States with a regional focus, which will permit the abolishment of uncertain and irrelevant provisions to promote transparency, and improve competitiveness of the regional economy.

With the putting in place of the regional investment code, locational choices of ECOWAS firms are now wider within an integrated regional market and investments of firms originating from non-ECOWAS member countries are now equally attracted to serve and exploit the consequent economies of scale and scope in the community. Codification of regional investment policies is equally expected to mobilize investment as a driving force for economic growth and development of ECOWAS Community. ECOWAS Investment Code seeks to provide the framework for designation of the region as a single investment location and is expected to enhance the regional investment climate.

CONCLUSION

As noted in the introduction, the aim of this paper is to examine and explore ways of securing Chinese foreign direct investment for lasting development in Africa, and particularly in West Africa, with the view of challenges faced by Chinese investors in Africa, the legal protection the host countries provide to its foreign investors to secure their profit and their own interest. The study also underlines which factors are instrumental in attracting Chinese foreign direct investment, and how a rise in FDI in West Africa, because of policy implementation, would ultimately influence output.

In this paper we collected data on the West African regional investment code putting in place by ECOWAS States members to provide good laws as essential promotional tool and confidence to investors and Government recently. Good laws clarify the role and responsibilities of private investors and Government, bind them to their respective rights and obligations, reduce the scope for discretionary decision-making, ensure transparency in administrative processes and certainty for investors, and provide a basis for dispute resolution (Aremu A. J., 2010). ECOWAS States members are in the process of harmonizing their investment policies in the region into a single code to simplify the investment regulatory regime. The regional investment code provides in its admission and establishment chapter the same treatment to all investors as well as Foreign Direct Investors. In its article 17, “Each Member State shall accord to investments made by investors of another Member State treatment no less favorable than that it accords, in like circumstances, to investments made by investors of any other Member State of the Community or of a third party with respect to the management, conduct, operation, expansion, sale or other disposition of investments”.

It was discovered that West African countries have become more helpful towards FDI over the last two decades, as shown among other things by changes in the countries regulatory regimes. This changing stance towards FDI has also resulted in an increase of investment promotion agencies, special economic zones and other focused mechanisms by which ECOWAS countries aspire to attract foreign investors. It

seems important and crucial first for the West African region to protect its domestic and foreign investments as well as China's.

This study helps us identify opportunities for economic development through securing Chinese direct investment in Africa and the necessary improvement of local laws in order to attract more significant foreign direct investors, in particular in West African countries, where some interesting legal instruments exist. It might trigger the critical question of the mutual benefits of the China-Africa Partnership and reduce the current risks related to foreign direct investment in all of Africa.

The prospects for attracting and keeping investment can be significantly improved when commitment to ECOWAS regional integration and harmonizing investment policies based on a high level commitment to the key principles and best practices for successful investment policies, prevail. Such simplification involves not only a business process but also cultural change in how ECOWAS nation states view those whom they regulate, and how those who are being regulated perceive the value and effectiveness of the regulation processes.

The limitation of this study includes its conceptual nature. The risk of Investment in Africa concerns endogenous matters. Factors that block the development of legal instruments, facilitators of foreign investment in African countries are not the same from one region to another. This often makes difficult study that treat all of Africa as a region. It should be helpful to proceed by regional grouping which unfortunately is also subject to problems on cultural matters of each regional organization. Each African country has a unique and important history and culture that govern its development philosophy. Our recommendation for future research is to identify if Chinese presence in Africa provides an advantage for regional organization development or if this partnership is suitable for the regional organization development or for only some selected countries.

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