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THE RELATIONSHIP BETWEEN CULTURAL DIMENSIONS AND INTERNATIONAL VENDOR SELECTION CRITERIA

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ABSTRACT

International vendor selection has been a lightly researched area of organizational buying behavior. The few studies in the field have examined differences in the importance of vendor selection criteria to purchasers across countries, but did not attempt to identify the potential cause of these differences. The present study surveyed purchasers in the United States and Germany and identified differences in the importance placed on vendor selection criteria factors. The study then took the additional step of examining to see if there was a relationship between these perceived differences and differences in the cultural dimensions of purchasers, a relationship which has been suggested but not tested by earlier studies. A relationship was found between Hofstede's cultural dimension of uncertainty avoidance and the vendor selection factors of quality, price, vendor reputation, firm characteristics and vendor attitude. In addition, a relationship was found between individualism and the quality, price and vendor attitude factors.

JEL: M16, M31

KEYWORDS: International Organization Buyer Behavior, International Vendor Selection

INTRODUCTION

This study examines the relationship between the importance placed upon international vendor selection criteria and the cultural dimensions of individual purchasers in the United States and Germany. In addition, vendor selection criteria factors were developed based on a set of commonly used vendor selection criteria variables for the first time. Importer behavior has been a relatively under researched area in the international exchange literature (Liang and Parkhe, 1997). The least studied stage of importer behavior has been vendor selection (Ghymn and Jaffe, 2003), even though this stage takes on increased importance when purchasing internationally (Liang and Parkhe, 1997).

There have only been a limited number of studies that have examined importer vendor search behavior in different countries. For the most part these studies examined vendor search when the buyers were purchasing a variety of goods and services. Because of the use of different goods and services it is difficult to draw any conclusions about perceived differences in buyer behavior. This study focuses on buyers purchasing the same type of software services in the United States and Germany. Services are the fastest growing segment of world trade, expanding at twice the rate of the trade in goods from 2005-2011 (WTO, 2012). By focusing on one type of service and collecting data on the cultural dimensions of individual purchasers in these countries, this study was able to explore the relationship between cultural variables and the importance placed on vendor selection criteria.

The goal of this study is to provide researchers and practitioners with one of the first building blocks in understanding the relationship between culture and international buyer behavior as well as to examine how this information might impact international marketers. A second contribution of this study is that it takes Dickson's (1966) often used vendor selection criteria variables and reduces them to a smaller grouping of vendor selection factors, as it has been suggested that purchasers combine vendor selection criteria into a smaller number of choices when buying (Rao and Seshandri, 1996). To conduct this research the variables were first slightly modified to reflect their use in the services and international trade. The identification of these particular factors for the first time will be helpful with future international vendor research. This paper will examine the literature relevant to this study in the areas of international vendor selection and cultures relationship to buying behavior, will discuss the data and methodology used in the study, provide the study's results, and will conclude with a discussion of the relevance and importance of the findings.

LITERATURE REVIEW

Each of the three original complex models of organizational buyer behavior (Robinson, Faris, and Wind, 1967, Webster and Wind, 1972, Sheth, 1973) contained multiple stages. The stage that has been cited as taking on increased importance in both services marketing and international buyer behavior is the vendor selection (selection of suppliers) stage (Liang and Parkhe, 1997, Berry, 2000, Hakansson and Wootz, 1975). It is, therefore, surprising that the vendor search stage has been identified as the least studied aspect of import behavior (Ghymn and Jaffe, 2003). Research in the area of international vendor selection is rather thin and fragmented. Much of the research in the field has been conducted by Ghymn, in conjunction with other researchers (Ghymn and Jaffe, 2003, Ghymn, Mattsson and Cho, 2001, Ghymn, Liesch and Mattson, 1999, Ghymn and Jacobs, 1993, Ghymn, Johnson and Zhang, 1993, Ghymn, Srinil and Johnson, 1993, Ghymn and Jacobs, 1983). Each of these studies was conducted in individual countries, though a few of the studies included cross country comparisons with results of earlier studies. Differences in the perceived importance placed upon vendor selection criteria were identified.

The criteria of price, quality and delivery were most often listed as being the most important, though the ranking of the three criteria varied by country. However, because the studies were conducted at different times, the exact products being purchased were not mentioned and the purchasers were from non-related groups, it is not possible to attribute the differences to country differences. A study by Thayer and Wilcox (2006) conducted in Canada found that three of the top six rated criteria were related to pricing. Two studies in the United States (Scully and Fawcett, 1994 and Alguire, Frear and Metcalf, 1994) identified price as being the primary motivation for companies to source internationally. Paul and Wooster (2010) found that the need to lower costs is a significant determinant in offshore outsourcing.
One of the few studies that linked the perceived importance placed on selected suppliers' attributes to differences in culture was conducted by Rao and Seshadri (1996) in India and Nigeria. While buying behavior differences were found between the two countries and attributed to culture based on differences in "uncertainty avoidance" and "individualism", this study also highlights the need for additional studies in the area. For example, cultural measurements were not done at the individual level and another country's (Turkey) cultural dimensions were substituted for Nigeria, because cultural dimension measurements were not available for Nigeria.

Several researchers have indicate that cultural differences are associated with international industrial buying behavior differences (Rao and Seshadri, 1996, Money, Gilley and Graham, 1998, Hewett, Money and Sharma, 2006, Carter, Maltz, Maltz, Goh and Yan, 2010). Khan, Niazi and Ahmad (2011) identified language and culture as the only common frequently cited barrier in offshore vendor selection. The most widely accepted cultural frameworks in marketing and international business research are Hofstede's (1980) cultural dimensions. Hofstede's (2001) five dimensions include uncertainty avoidance, individualism, power distance, masculinity, and long-term versus short-term orientation. Of these five dimensions, the dimensions of uncertainty avoidance and individualism have been identified as having the greatest impact on international buying behavior (Rao and Seshadri, 1996, Murray and Blenkhorn, 1983, Bowman, Farley and Schmittlein, 2000, Roth, 1995; Straughan and Albers-Miller, 2001). However, the relationship between these two critical dimensions and the importance that international services buyers place on vendor selection criteria has never been studied at the individual level. Examining the relationship of culture to the importance of vendor selection criteria may be clearer when the purchase of a service is studied. This is because of the potential for culture to have a greater impact on service providers, as opposed to goods providers, as mentioned often in the international services literature (Samiee, 1999, Javalgi and White, 2002; Berthon, Pitt, Katsikeas and Berthon, 1999, Reardon, Erramilli and Dzousa 1996, Fugate and Zimmerman 1996, Stauss and Mang 1999, Swift 1999, Lovelock 1999, Van Birgelen, de Ruyter and Wetzels, 2000). Reasons provided for culture's greater impact on services providers include the close interaction required between customers and service vendors exacerbating cultural differences, and the difficulty of controlling perceptions regarding an intangible service in another culture (Reardon, Erramilli and Dzousa, 1996, Fugate and Zimmerman, 1996).

The increased importance of the vendor selection stage to buyers when purchasing internationally (Liang and Parkhe, 1997, Hakansson and Wootz, 1975) and when buying services as opposed to goods (Berry, 2000) has also been identified. Berry (2000) found that due to the intangible nature of services (where a service often can't be seen or touched) buyers rely more on their evaluation of the vendor, as opposed to the service, when selecting a service. The Hakansson and Wootz (1975), Dickson (1966), Dempsey (1978), and Cardoza and Cagley (1971) studies did examine the impact of uncertainty on vendor selection in a domestic setting. However, it was the uncertainty of the buying situation as opposed to the uncertainty avoidance of the buyer that was discussed. Hakansson and Wootz (1975) found that buyers in high uncertainty situations cited a vendor's geographic location as the most important vendor selection criterion, whereas price was identified as the most important vendor characteristic in low uncertainty situations. Dickson (1966) and Dempsey (1978) similarly concluded that the lower the perceived risk, such as the purchase of office supplies, the greater the importance placed on price. Cardoza and Cagley (1971) found that the higher the perceived risk, the greater the importance placed on the vendor's reputation.

DATA AND METHODOLOGY

The purpose of this research study is to determine if there are differences in the perceived importance that international buyers place on vendor selection criteria across cultures for a given buying situation. This study employed a cross sectional survey in the United States and Germany to determine the perceived importance purchasers placed on vendor selection criteria. The cultural dimensions of the respondents were also measured at the individual level. The survey instrument was translated to German and then back-translated to English by individuals fluent in both English and German, who also had experience in the computer software field. A pretest using concurrent think-aloud interviews was conducted with a panel of experts. In addition, the think aloud method was used with four respondents in Germany to understand their interpretation of the German language survey questions as they completed the survey, to test if the intent of the questions was translated correctly. The date was collected in 2008.

The target audience for this research was organizational buyers from organizations that had purchased an intellectual property (IP) legal software system within the last three years, or organizations that were contemplating the purchase of IP software. Contact information for the organizational buyers was obtained from a marketing database provided by a leading IP software system provider. There were 2,017 potential contacts in the United States, and 933 potential contacts in Germany. The response rate in the United States was 7.8 percent (157 survey responses) and the response rate from Germany was 10.2 percent (95 survey responses). The vendor selection criteria used in this study were Dickson's (1966) vendor selection criteria (modified for the services trade), and updated with the addition of one criterion identified in the international vendor choice literature. The initial vendor selection criteria used in the study is included in Table 1.

Table 1: Vendor Selection Criteria

1. The net price (including discounts and freight charges) offered by each vendor.
2. The ability of each vendor to meet quality specifications consistently.
3. The support services likely to be given by each vendor.
4. The ability of each vendor to meet specified delivery schedules.
5. The geographical location of each vendor.
6. The financial position and credit rating of each vendor.
7. The production facilities and capacity of each vendor
8. The amount of past business that had been done with each vendor.
9. The technical capability (including research and development facilities) of each vendor.
10. The management and organization of each vendor.
11. The future purchases each vendor would be expected to make from your firm.
12. The communication system (with information on progress data of orders) of each vendor.
13. The operational controls (Including reporting, quality control, and inventory control system) of each vendor.
14. The position in the industry (including product leadership and reputation) of each vendor.
15. The labor relations record of each vendor.
16. The attitude of each vendor toward your organization.
17. The desire for your business shown by each vendor.
18. The warranties and claims policies of each vendor.
19. The ability of each vendor to meet your packaging requirements for his product.
20. The impression made by each vendor in personal contacts with you.
21. The availability of training aids and educational courses in the use of the product of each vendor.
22. Compliance or likelihood of compliance with your procedures (both bidding and operating) by each vendor.
23. The performance history of each vendor.
24. Responsiveness to your needs of each vendor.

Based on the results of the "think aloud" pretests conducted with IP software buyers, the following changes were made to the variables to reflect their use in the software buying process: "Annual maintenance charge of each vendor" was added, since it is an important criterion when purchasing software. Item number 3 was modified from Dickson's "The repair service likely to be given by each vendor." to "The support services likely to be given by each vendor.", However, the "Labor relations record", "Packaging ability" and "Reciprocal arrangements" criteria were removed, since they did not apply to the software industry in this study.

Each item was measured using a 5-point scale, with anchor points being "very important to not important". Dickson's vendor selection criteria have not previously been reduced to a smaller number of factors, although it has been suggested that buyers combine criteria into a smaller number of choices to simplify the decision process when selecting vendors (Rao and Seshandri, 1996). An exploratory factor analysis was, therefore, run using the responses to the vendor selection criteria questions listed above. Based on the exploratory factor analysis, five vendor selection criteria factors were identified. The "Operating Controls", "Training aids", and "Responsiveness to needs" criteria were dropped based on the exploratory factor analysis results. The "Performance history" criterion was dropped due to the confirmatory factor analysis results. Table 2 displays the remaining five vendor selection factors, with their corresponding criteria listed below.

Table 2: Final Factor Analysis Vendor Selection Factors

Factor	Variables
Quality	Quality Technical Capability Support Services Warranty & Claims Policies Procedural Compliance
Price	Price Annual Maintenance Charge
Firm Characteristics	Production Facilities and Capacity Geographic Location Financial Position
Vendor Reputation and Past Business	Amount of Past Business Management and Organization Reputation and Position in Industry
Vendor Attitude	Desire for Business Attitude Impression

Hofestede's dimensions were originally evaluated at the country level, however, it was deemed appropriate to examine the cultural dimensions at the individual level for this study. The uncertainty avoidance and individualism levels were therefore measured using Jung's (2002) individual level measurements. Multiple regression analysis was used to examine the relationship between uncertainty avoidance (UA) and individualism (IND), and the perceived importance of the vendor selection criteria factors. The following multiple regression model was used to address these relationships: Perceived Importance = $b_0 + b_1$ UA + b_2 IND + e

Research Objectives

A review of the literature indicates that there were differences across countries in the perceived importance buyers place on vendor selection criteria (Ghymn and Jaffe, 2003, Ghymn and Jacobs, 1993). Cultural differences have been identified as being related to buyer behavior differences across countries (Rao and Seshadri, 1996, Lowe and Corkindale, 1998, Grunert and Scherhorn, 1990, Clark, 1990). Hofstede's (1980) uncertainty avoidance and individualism dimensions have been identified as the two cultural dimensions most responsible for impacting differences in international buyer behavior (Rao and Seshadri, 1996, Murray and Blenkhorn, 1983, Bowman, Farley and Schmittlein, 2000, Roth, 1995, Straughan and Albers-Miller, 2001).

This cultural difference based explanation for differences in buyer behavior is partially supported by several studies. Rao and Seshadri (1996) located differences between India and Nigeria in the importance placed on selected supplier-attributes by industrial buyers, and attributed the differences to culture. Yaveroglu and Donthu (2002) found that societies that are lower on individualism and higher on uncertainty avoidance (Japan) were higher on imitation than societies higher on individualism and lower on uncertainty avoidance (the United States). Individuals in Japan have been found to have a tendency to collect more information from their peers about their experiences before purchasing. In a similar study, Money, Gilley and Graham (1998) found that risk averse and less individualistic Japanese companies were more likely to use word-of-mouth referrals, than less risk averse and more individualistic American companies. Based upon the proceeding discussion and a review of the literature, the following general research propositions are advanced:

P1: There is a relationship between an individual's level of uncertainty avoidance and the perceived importance of vendor selection factors.

P2: There is a relationship between an individual's level of individualism and the perceived importance of vendor selection factors.

In general, the following sub-propositions are based on the premise that individuals with lower uncertainty avoidance and higher individualism levels (the United States) have less concern about the risk involved in the non-tangible vendor selection factors of quality, firm characteristics, vendor reputation and vendor attitude. These purchasers, therefore, put a greater emphasis on the more tangible vendor selection factor of price. However, individuals with higher uncertainty avoidance and lower individualism levels (Germany) put less emphasis on price and greater emphasis on the less tangible vendor criteria of quality, firm characteristics, vendor reputation and vendor attitude. The sub-propositions for Proposition 1 and 2 follow, detailing the expected relationship between uncertainty avoidance (and individualism) and the individual vendor selection factors:

P1A: There is a positive relationship between an individual's level of uncertainty avoidance and the perceived importance of the "Quality" vendor selection criteria factor.

P1B: There is a negative relationship between an individual's level of uncertainty avoidance and the perceived importance of the "Price" vendor selection criteria factor.

P1C: There is a positive relationship between an individual's level of uncertainty avoidance and the perceived importance of the "Firm Characteristics" vendor selection criteria factor.

P1D: There is a positive relationship between an individual's level of uncertainty avoidance and the perceived importance of the "Vendor Reputation/Past Business" vendor selection criteria factor.

P1E: There is a positive relationship between an individual's level of uncertainty avoidance and the perceived importance of the "Vendor Attitude" vendor selection criteria factor.

P2A: There is a negative relationship between and individual's level of individualism and the perceive importance of the "Quality" vendor selection criteria factor.

P2B: There is a positive relationship between an individual's level of individualism and the perceived importance of the "Price" vendor selection criteria factor.

P2C: There is a negative relationship between an individual's level of individualism and the perceived importance of the "Firm Characteristics" vendor selection criteria factor.

P2D: There is a negative relationship between an individual's level of individualism and the perceived importance of the "Vendor Reputation/Past Business" vendor selection criteria factor.

P2E: There is a negative relationship between an individual's level of individualism and the perceived importance of the "Vendor Attitude" vendor selection criteria factor.

RESULTS AND DISCUSSION

Multiple regression analysis was used to test Propositions P1A through P1E. Table 3 displays the results of regressing the independent measure, the Uncertainty Avoidance factor, with the Vendor Selection Criteria factors.

Table 3: Multiple Regression Results For Vendor Selection Factors and Uncertainty Avoidance in the United States and Germany (N=252)

Dependent Variables	T-statistic	P value	R-squared
Quality	4.02	0.001*	0.29
Price	-5.36	0.001*	0.36
Firm Characteristics	1.94	0.053**	0.05
Vendor Reputation	1.91	0.058**	0.12
Vendor Attitude	3.26	0.002*	0.13

This table shows the regression estimates of the equation: Perceived Importance = $b_0 + b_1\ UA + e$*. The dependent variables listed are the five Vendor Selection Criteria. ** and * indicate significance at the 10 and 5 percent levels respectively.*

The results indicate there is a positive relationship between an individual's level of uncertainty avoidance and the perceived importance of the "Quality" and "Vendor Attitude" vendor selection criteria factors in the United States and Germany, which supports Proposition P1A and P1E. The uncertainty avoidance factor also had a significant negative relationship with the perceived importance of the "Price" vendor selection criteria factor in the United States and Germany, which supports proposition P1B.

The results of the analysis of uncertainty avoidance and the perceived importance of the "Firm Characteristics" and the "Vendor Reputation" vendor selection criteria factors only found a marginally significant positive relationships, which partially supports proposition P1C and P1D. Multiple regression analysis was also used to test Propositions P2A through P2E. Table 4 displays the results of regressing the independent measure, the Individualism factor, with the Vendor Selection Criteria.

Table 4: Multiple Regression Results For Vendor Selection Factors and Individualism in the United States and Germany (N=252)

Dependent Variables	T-statistic	P value	R-squared
Quality	-5.38	0.001*	0.29
Price	4.06	0.001*	0.36
Firm Characteristics	-0.46	0.643	0.05
Vendor Reputation	-1.47	0.142	0.12
Vendor Attitude	-2.09	0.037*	0.13

*This table shows the regression estimates of the equation: Perceived Importance = $b_0 + b_1$ IND + e . The dependent variables listed are the five Vendor Selection Criteria. ** and * indicate significance at the 10 and 5 percent levels respectively."*

The results indicate that individualism has a significant positive relationship with the perceived importance of the "Price" vendor selection criteria factor. This study, therefore, supports Proposition P2B. The results of the regression analysis indicate that individualism has a significant negative relationship with the perceived importance of the "Quality" and "Vendor Attitude vendor selection criteria factors, which supports propositions P2A and P2E. Individualism did not have a significant relationship with the perceived importance of the "Firm Characteristics" and "Vendor Reputation" vendor selection criteria factors. Consequently, the study does not support proposition P2C and P2D. Overall, Proposition P1, that there is a relationship between Uncertainty Avoidance and the five vendor selection factors, is supported, as there is a significant or marginally significant relationship between uncertainty avoidance and each of the vendor selection factors. However, Proposition P2, that there is a relationship between individualism and the five vendor selection factors, is only partially supported.

These Uncertainty Avoidance relationship results were not unexpected, as previous studies had indicate that quality is considered the vendor selection criteria of most importance in countries that are relatively high on the uncertainty avoidance dimension, such as Israel, Japan, and Thailand (Ghymn and Jaffe, 2003, Ghymn and Jacobs, 1993, Ghymn, Srinil and Johnson, 1993). These findings also support previous studies which had found price was the vendor selective criteria of greatest perceived importance in countries which had relatively low uncertainty avoidance levels, such as the United States, Canada and Denmark (Ghymn and Jacobs, 1983, Thaver and Wilcock, 2006, Overby and Servais, 2005). Conversely, price was of lower perceived importance in countries with a relatively high uncertainty avoidance level, such as Japan, China and Thailand.

The results of the study in regard to the individualism were not as conclusive as they were with uncertainty avoidance. This result was not surprising in that while uncertainty avoidance is often identified as being related to international buyer behaviors in the literature, individualism is often mentioned as being a secondary influence, as in the international buyer behavior study of Bowman, Farley and Schmittlein (2000). Diamantopoulos, et.al. (2003) went even further, stating that uncertainty avoidance was the one dimension from Hofstede's (1980) cultural framework that would be particularly helpful in exploring buying behavior across countries. That said, the study did find there was a significant relationship between individualism and the perceived importance of the quality, price and vendor attitude vendor selection criteria.

CONCLUDING COMMENTS

This study had two primary goals. It is the first study to expand Dickson's (1966) vendor selection criteria to an international setting. Dickson's work is often cited as a foundational vendor selection study, but the work had not been used in an international arena. The study also reduced these vendor selection criteria to a smaller number of factors. These factors were similar to those first proposed and appear to be intuitively logical. The availability of these factors will benefit researchers looking to extend this research into other countries, and in the examination of vendor selection with other products. This research was also unique in proposing a relationship between an individual(s) levels of uncertainty avoidance and individualism, and the perceived importance of vendor selection factors. The few importer vendor selection studies that incorporated culture previously, such as Rao and Seshadri's (1996) study, used Hofstede's cultural dimensions at the country level.

In addition, the finding that uncertainty avoidance and individualism are related to differences in the perceived importance of vendor selection criteria in the United States and Germany was based on a study involving a single service and similar samples of respondents. Earlier studies had not identified the specific good or service being considered, with some even mixing consumer and industrial products, and had used respondents obtained from different contact lists in each country. While vendor selection differences were found in these studies, it was not possible to identify the causes of these differences. The methodology used in this study allowed the research to attribute differences in the perceived importance of vendor selection criteria to cultural dimensions.

This research has several limitations that should be considered. First, the service being studied is customized intellectual property legal software. It cannot be assumed that the results of the study can be applied to other services without future research, as Park, Krishman and Lee (2012) have found that vendor selection criteria differ by industry. Second, this study includes organizations located in the United States and Germany. Again, the results of the study cannot be generalized to other countries without further research. Finally, this study limits the focus to culture in regard to the impact on the perceived importance of vendor selection criteria across countries. While a review of the literature and discussions with industry experts did not uncover any other factors, there is the possibility of other factors impacting the perceived importance of vendor selection criteria across countries.

This research highlights the need for additional research in the area. The study measured the perceived importance of vendor selection factors in regard to the purchase of computer software. It would be of interest to see if similar results are found when examining vendor selection in regard to other services and goods. There is a need to further study differences in vendor selection criteria for individual services and goods, as much of the earlier research in the field has not identified the exact service or good being purchased. This study identified a relationship between individual(s) levels of uncertainty avoidance and individualism, and the perceived importance of vendor selection factors in the United States and Germany. This research should be expanded to other countries to determine if the findings can be generalized beyond these two countries. Many other countries have been found to have greater cultural dimension differences than the United States and Germany (Hofstede 1980), and it would be of interest to see if these cultural differences impact the perceived importance of vendor selection factors in these countries. In short, this study is a beginning in examining the relationship of culture to international buyer behavior. However, there is much room for expansion, as it would be interesting to explore if the findings hold for other countries, products and steps in the buying process.

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USE OF DEPRECIATION AS A TAX POLICY DEVICE TO CONTROL INFLATION

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ABSTRACT

The United States Internal Revenue Code contains many provisions for credits, deductions, and other tax advantages intended to achieve various economic goals considered desirable by the U.S. Congress. The depreciation allowance is one such deduction, frequently used to compensate taxpayers for the effects of inflation and to promote economic growth. The government uses it extensively as a part of tax-incentive programs based on the theory that tax benefits stemming from depreciation reduce the cost of doing business, and thus stimulate capital formation by allowing tax-free recovery of capital by businesses. Capital formation increases productive capacity by providing resources to those companies that can use them to expand business operations. The expected increase in productivity would result in more goods and services in the economy, which in turn would act to keep prices down and help suppress inflation. Congress has realized the importance of capital formation to control inflation and thus, over time, has extended significant tax advantages to businesses through depreciation. This paper examines the effectiveness of depreciation as a means of stimulating capital formation and of controlling inflation.

JEL: H2, H4, H8

KEYWORDS: Depreciation, Tax Policy Device, Inflation, U.S. Congress, Capital Formation, Internal Revenue Code

INTRODUCTION

Depreciation is a deduction from the taxable income of a business for exhaustion, wear and tear, and obsolescence of property used in the course of that entity's income-producing activities. Due to these factors, physical plants, machinery, equipment and other types of physical assets lose their value with the passage of time. Consequently, the Internal Revenue Code allows a deduction for the depreciation of physical assets used in a business (I.R.C. § 167 and 168, 1986). The amount of depreciation allowed for tax purposes is a product of the acquisition cost of the assets, their estimated useful life, and (if required) their salvage value. The annual depreciation deduction is determined by allocating the acquisition cost of the assets over their service life by means of a systematic allocation method. One may assume that depreciation deduction is intended to provide funds to replace such property at the end of its useful life (United States v. Ludey, 1925). However, as a practical matter, depreciation is not an objectively determinable figure; it is an estimate based upon individual judgments or market data. The amount allowed for depreciation by the Code may not be equal to the actual decrease in an asset's market value (Portland General Elec. Co. v. U.S., 1969). In reality, depreciation is determined legislatively based on the policies adopted by the Congress, which has used depreciation frequently, in various forms, over a span of decades to stimulate investment and economic growth. It is not, therefore, possible to estimate the true rate of depreciation of every asset in the actual economy (Congressional Budget Office, 1985).

Depreciation is one of the most important factors considered in business and regulatory accounting in order to determine taxable business income, and to measure the growth of the economy. Accurate measures of income are necessary in order for government to accurately gauge the success of economic and financial programs, including the control of inflation. Several studies have indicated that Congress has not always been successful in its attempts to promote investment and to control inflation through depreciation allowance (Barry P. Bosworth, 1985). Rather, frequent changes in depreciation methods have widened the gap between tax depreciation and economic depreciation, or the real loss in the value of physical assets. The original intention of Congress was to allow taxpayers a reasonable allowance for depreciation. Historically, an asset's depreciable life was set equal to its estimated economic life.

However, the Internal Revenue Code, 1954 Section 167(b) provides that, for assets purchased after 1953, the term "reasonable allowance" shall include an allowance computed under certain specified methods. This language took away the taxpayers' ability to estimate a reasonable allowance for depreciation. Furthermore, the Accelerated Cost Recovery System of 1981 created several different classes of assets, each with arbitrarily-prescribed recovery periods which differ from those assets' expected economic lifespans. Substantial changes in the depreciation system arose out of the Tax Reform Act of 1986. The Act of 1986 introduced the Modified Accelerated Cost Recovery System (MACRS). The arguments in support of MACRS included the assertions that both the ACRS and pre-ACRS depreciation methods had been defective. ACRS had been founded on unrealistic assumptions of the lifespans of depreciable assets, whereas the pre-ACRS methods did not take inflation into account. Thus MACRS aimed to preserve investment incentives while explicitly accounting for inflation and different rates of economic depreciation (President Tax Proposals, 1985). Table 1 shows the major classes of assets, and Table 2 shows the recovery allowance percentage for some of the major classes of property under the Modified Accelerated Cost Recovery System of 1986.

Table 1: Major Classes and Asset Lifespans under MACRS

Class	Type of Property
3-year	Certain special manufacturing tools
5-year	Automobiles, light-duty trucks, computers, and certain special manufacturing equipment
7-year	Most industrial equipment, office furniture, and fixtures
10-year	Certain longer-lived types of equipment

Source: Partial table constructed from Financial Management, Brigham & Ehrhardt, 14th ed., page 482, 3014. The recovery periods under MACRS rules are not based on the actual useful life of assets. In many cases, the allowed depreciation periods are significantly shorter than the economic lifespan of the assets in question. Thus MACRS allows more rapid cost recovery than is possible under straight-line depreciation.

Table 2: Annual Recovery Allowance Percentages for Property, by Investment Class

	3-Year	5-Year	7-Year	10-Year
Year 1	33.33	20.00	14.29	10.00
Year 2	44.45	32.00	24.49	18.00
Year 3	14.81	19.20	17.49	14.40
Year 4	07.41	11.52	12.49	11.52
Year 5		11.52	08.93	09.22
Year 6		05.76	08.92	07.37
Year 7			08.93	06.55
Year 8			04.46	06.55
Year 9				06.56
Year 10				06.55
Year 11				03.28
Total (%)	**100**	**100**	**100**	**100**

Sources: Partial table constructed from Financial Management*, Brigham & Ehrhardt, 14th edition, Page 483, 3014. The fixed annual recovery allowance percentages under MACRS fail to take into account fluctuations in the rate of inflation. The recovery allowance percentage for various classes of assets is fixed; however, frequent fluctuations in inflation rates create variances in the effective tax rates for assets.*

The Modified Accelerated Cost Recovery System was designed to shorten the depreciable lives of assets, and thus to allow businesses to take advantage of large deductions at an earlier point in time. The higher depreciation allowance lowers the amount of taxable income, resulting in a smaller amount of taxes. At the same time, this can motivate taxpayers to allocate capital in non-productive assets, which widens the gap between tax depreciation and real capital loss. Thus, MACRS defeats the primary objective of depreciation, which is to provide a reasonable estimate of an asset's decreased value. Furthermore, the system could be seen as a harmful tax policy because it encourages capital to be allocated simply to gain a tax advantage. The purpose of this paper is to examine the relationship between the primary objective of depreciation and the effectiveness of U.S. tax policy in stimulating investment and compensating for the effects of inflation since 1913.

LITERATURE REVIEW

Since the inception of the income tax system, Congress has allowed taxpayers the right to a depreciation deduction for the loss in value of property used in business (Revenue Act of 1909, and Revenue Act of 1913,). As the allowance for depreciation of property is merely an estimate of the actual change in value, the Internal Revenue Service issued Bulletin "F" on August 31, 1920, delegating to taxpayers the right to determine reasonable rates of depreciation based upon their own judgments and experiences (U.S. Bureau of Internal Revenue,1920). Thus, tax depreciation initially meant economic depreciation as estimated by the taxpayer, with the underlying objective of providing funds to replace depreciable assets used in the business (United States v. Ludey, 1925). Increased accuracy in the measurement of income and the collection of revenue were among the basic economic objectives underlying this depreciation deduction (United States v. Ludey, 1925).

The administrative approach to depreciation remained unchanged for almost 25 years, until the Great Depression of 1934 brought about a change in the government's fiscal priorities. To help finance the public works launched during the Depression, the Treasury Department narrowed depreciation deductions and required taxpayers to prove that the lifespans given for their depreciable assets were appropriate (T.D. 4422, 1934, C.B. 58.). The primary purpose of this new approach was to assure the reasonableness of any claim by taxpayers for depreciation, and to increase the amount of revenue collected.

This approach changed again in 1946, when the use of accelerated depreciation and liberal cost recovery methods were sanctioned by the government; these methods were later codified in 1954 (I.R.C § 167 (b), 1954). Accelerated depreciation methods assume that the annual decline in an asset's value will be higher in the early years of the asset's life (President's Tax Program, 1978); as a result, higher depreciation deductions were allowed in the years immediately following the acquisition of those assets, followed by smaller annual deductions for the remainder of an asset's lifespan. The Internal Revenue Code of 1954 maintained the general provisions of the earlier tax law, which had viewed depreciation deductions as a "reasonable allowance" for exhaustion, wear, and tear. However, the Internal Revenue Code provided that, for the assets purchased after 1953, the term "reasonable allowance" would include an allowance computed under certain specified methods, which allowed faster cost recovery (I.R.C § 167, 1954).

The Code provided for the following alternative depreciation methods: (1) the straight-line method, (2) the declining-balance methods, (3) the sum-of-the years digits method, or (4) any other consistent method that does not result in greater total depreciation being claimed during the first two-thirds of the asset's useful life than would have been allowable under the double declining balance method. Permissible methods include both machine hours and units of production methods, (I.R.C. § 167 (b) (4), 1954). The stated justifications for permitting faster cost recovery were administrative convenience, proximity to economic depreciation, and an incentive for capital investment – the last of which was expected to increase production (H.R. Rep. No. 1937, 1954). It was assumed that accelerated depreciation would result in taxpayers recouping most of the cost of their investments more quickly, which in turn would provide a greater tax savings. Tables 3, 4, and 5 compare the present value of tax savings under the straight line, double declining balance, and sum of the year's digits methods for an asset with an initial cost of $100,000 and an estimated useful life of 10 years, and no salvage value**;** the assumed corporate tax rate is 34 percent, with an assumed interest rate of 8 percent:

Table 3: Straight-Line Method

Year	Depreciation	Tax Savings	Present Value Interest Factor	Present Value of Tax Savings
1	$10,000.00	$3,400.00	0.92593	$3,148.16
2	10,000.00	3,400.00	0.85734	2,914.96
3	10,000.00	3,400.00	0.79383	2,699.02
4	10,000.00	3,400.00	0.73503	2,499.10
5	10,000.00	3,400.00	0.68053	2,313.80
6	10,000.00	3,400.00	0.63017	2,142.58
7	10,000.00	3,400.00	0.58349	1,983.87
8	10,000.00	3,400.00	0.54027	1,836.92
9	10,000.00	3,400.00	0.50025	1,700.85
10	10,000.00	3,400.00	0.46319	1,574.85
Total				$22,814.10

Table 4: 200 Percent Declining Balance Method

Year	Start-of-Year Book Value	Rate on Declining Balance (%)	Depreciation Expense	Book Value at Year-End	Tax Savings	Present Value Interest Factor	Present Value of Tax Savings
1	$100,000.00	0.2	$20,000.00	$80,000.00	$6,800.00	0.9259	$6,296.32
2	80,000.00	0.2	16,000.00	64,000.00	5,440.00	0.8573	4,663.92
3	64,000.00	0.2	12,800.00	51,200.00	4,352.00	0.7938	3,454.75
4	51,200.00	0.2	10,240.00	40,960.00	3,481.60	0.7350	2,559.08
5	40,960.00	0.2	8,192.00	32,768.00	2,785.28	0.6805	1,895.47
6	32,768.00	0.2	6,553.60	26,214.40	2,228.22	0.6302	1,404.16
7	26,214.40	0.2	5,242.88	20,971.52	1,782.58	0.5835	1,040.12
8	20,971.52	0.2	4,194.30	16,777.22	1,426.06	0.5403	770.46
9	16,777.22	0.2	3,355.44	13,421.77	1,140.85	0.5003	570.71
10	13,421.77	0.2	2,684.35	10,737.42	912.68	0.4632	422.74
Total			$89,262.60				$23,077.73

Table 5: Sum-of-the-Years' Digits Method

Year	Base	Rate (%)	Depreciation	Tax Saving	Present Value Interest Factor	Present Value of Tax Savings
1	$100,000	18.18	$18,181.82	$6,181.82	0.9259	$5,723.93
2	$100,000	16.36	16,363.64	5,563.64	0.8573	4,769.93
3	$100,000	14.55	14,545.45	4,945.45	0.7938	3,925.85
4	$100,000	12.73	12,727.27	4,327.27	0.7350	3,180.68
5	$100,000	10.91	10,909.00	3,709.09	0.6805	2,524.15
6	$100,000	09.09	9,090.91	3,090.91	0.6302	1,947.80
7	$100,000	07.27	7,272.73	2,472.73	0.5835	1,442.81
8	$100,000	05.45	5,454.55	1,854.55	0.5403	1,001.96
9	$100,000	03.64	3,636.36	1,236.36	0.5003	618.49
10	$100,000	01.82	1,818.18	618.18	0.4632	286.34
Total						$25,421.94

A comparison of the present value of tax savings under the straight-line method of depreciation with, liberal cost recovery method the 200 percent declining balance method, and the sum of the year digits method. This analysis reveals that the present value of tax savings under liberal cost recovery (i.e. accelerated cost recovery) methods is higher than the present value under the straight-line method.

This comparison shows that the present value of tax savings under the straight-line method is $22,814.10; the value under the 200 percent declining balance method is $23,077.73; and the value under the sum of the year digits method is $25,421.94.Theoretically, accelerated depreciation is the result of both financial considerations and economic environment.

Financial Considerations

A theoretical focus on financial considerations suggests that physical assets should be depreciated as rapidly as possible. The rationale underlying this theory is that the depreciating items have been purchased in past years to provide additional funds to the enterprise in the future. Depreciation is a noncash charge; therefore, the depreciation allowance provides cash flow that can be invested in the business to encourage future production (Department of the Treasury, Bulletin F 26-27, 1920). The choice of depreciation methods substantially affects accounting income and, consequently, influences the managers' capital investment decisions. Accelerated depreciation is more favored by managers then the straight line depreciation, which has economic impact on the economy as a whole (Bronwyn H. Hall, 2007). .

Economic Environment

Due to post-World War II inflation, the replacement costs of fully depreciated assets were often found to be higher than the total depreciation charged on such assets. Congress became concerned that the real value of the depreciation allowance had declined due to inflation, thereby reducing the profitability of business investments. Accelerated depreciation was intended to compensate taxpayers for the effects of inflation on depreciation and, as a result, on taxes. Accelerated depreciation was justified on the grounds that it implicitly compensated taxpayers for inflation (John P. Steines, 1985). After the Second World War, the industrial nations of Western Europe and Japan attempted to stimulate business investments by providing depreciation incentives (Hiromitsu Ishi, 1989). This tax policy was based upon tax incentives to achieve specific goals, as well as successive tax cuts to maintain a lower income tax rate. The United States followed the example of other industrial nations and attempted to stimulate investments through depreciation incentives. In 1958, Congress passed the Technical Amendment Act, which enacted I.R.C. Section 179 to assist small businesses. I.R.C. Section 179 allowed an immediate deduction, not to exceed $20,000 annually, for the cost of tangible personal property purchased with a useful life of at least six years (The Technical Amendment Act, 1958). The Internal Revenue Code added a provision which allowed business to report their depreciation expenses, which was the equivalent of depreciating up to $125,000 of equipment over one year (Internal Revenue Service Publication 946).

Following these legislative changes in the depreciation system, another significant development on the administrative level came in 1962 when the IRS issued Revenue Procedure 62-21, which withdrew Bulletin F and provided a list of guidelines for broad classes of assets by industry use, as opposed to Bulletin F's asset-by-asset approach (Rev. Proc. 62-21, 1962 C.B. 418.). The new guidelines placed greater emphasis on the economic lives of the assets rather than their physical lives, resulting in a 30 to 40 percent reduction in write-off periods (Depreciation Guide - MACRS, 11, 1991). Another change occurred in U.S. tax policy when Congress passed the Tax Reform Act of 1969. As opposed to the earlier practice of allowing liberal cost recovery, the Tax Reform Act of 1969 imposed several restrictions on accelerated depreciation (The Tax Reform Act, 1969). In 1970's, the United States faced high inflation and retarded economic growth. Hence, to provide tax incentive to businesses, Congress passed the Revenue Act of 1971 which introduced the Asset Depreciation Range System to liberalize the cost recovery system (The Revenue Act of 1971).

Tables 6 and 7 detail the increase in the rate of inflation, high deficits, and a decline in productivity in the 1970's – all of which revealed the weakness of the depreciation allowance as a means to stimulate business investment. The increased rate of inflation during the decade of the 1970's challenged the historical justification of cost-based depreciation (Karen Mathias, 1987). The effective tax rate on capital increased because depreciation was not based on actual replacement costs.

Table 6: Annual Percentage Changes in Consumer Prices in the United States, 1978-87

Year	Percent Change
1978	07.6
1979	11.3
1980	13.5
1981	10.3
1982	06.2
1983	03.2
1984	04.3
1985	03.6
1986	01.9
1987	03.7

Source: U.S. department of Commerce, Bureau of the Census. Statistical Abstract of the United States*, 113th Edition, 1993, p. 482. Table 6 shows the annual percentage change in the consumer price index from 1978-1987. Rising oil prices, increased costs of social welfare and regulatory activities, wage increases, and international pressure are some of the factors that contributed to inflation during this period.*

Table 7: Summary of Receipts and Outlays, U.S. Budgets (in Billions of Dollars)

Fiscal Year	Receipts	Outlays	Deficits
1978	399.6	458.7	059.2
1979	463.3	503.5	040.2
1980	517.1	590.9	073.8
1981	599.3	678.2	078.9
1982	617.8	745.7	127.9
1983	600.6	808.3	207.8
1984	666.5	851.8	185.3
1985	734.1	946.3	212.3
1986	769.1	990.3	221.2
1987	854.1	1,004.6	150.4

Sources: Executive Office of The President, Office of Management and Budget, The United States Budget in Brief, Fiscal Year 1988*, page 97; and* The United States Budget in Brief, Fiscal Year 1989, *page 101. As shown in Table 7, the government of the United States had a long trend of budget deficits. Social welfare activities, wage increases, and changes in the international economic environment, along with a declining rate of productivity, caused the amount of the budget deficit to rise.*

The resulting decrease in the after-tax rate of return was thought to have discouraged savings and investment. Inadequate cost recovery allowances were presumed to have contributed directly to insufficient capital investment. Therefore, it was argued that cost recovery allowances had to be liberalized in order to encourage capital formation. The result of this debate was the enactment of the Economic Recovery Tax Act (The Economic Recovery Tax Act, 1981and Senate Report, 1981). The Economic Recovery Tax Act (ERTA) was intended to stimulate savings by increasing the rate of return through tax-rate reduction and indexing for inflation. In particular, ACRS was meant to compensate taxpayers for inflation by allowing for the depreciation of assets over shorter timeframes, and thus increasing investments in plants and equipment (Douglas Greenwald, 1982, and Alvin C. Warren Jr. et al.

1982). The ERTA widened the gap between tax depreciation and economic depreciation by disassociating the time period over which an asset's cost was to be recovered from the actual lifespan of the asset. The cost recover periods prescribed by the Act were substantially shorter than the actual useful lives of depreciable assets. ERTA's separation of tax depreciation from economic depreciation was initiated by the changes in depreciation schedules based on economic useful lives through tax reforms made in 1982, 1984, 1986, and 1993 (Tax-Equity and Fiscal Responsibility Act, 1982, Deficit Reduction Act, 1984, Tax Reform Act, 1986, and Omnibus Budget Reconciliation Act, 1993).

The Tax Reform Act of 1986 made further substantial changes in the depreciation system by introducing MACRS. This legislation increased the number of recovery classes and extended the recovery periods for many assets. The objective of MACRS was to preserve investment incentives while accounting for inflation through different rates of depreciation. Changes in the depreciation method made by the Tax Reform Act of 1986 were based on the philosophy that the depreciation allowance should reflect the fact that, on average, the value of assets declines over time due to variety of factors; therefore, if a depreciation allowance understates real depreciation, income from the investment is overtaxed. This results in a disincentive to invest in those assets, which in turn impairs capital formation and reduces the economy's productive capacity (Allan J. Auerbach et al, 1980). Similarly, if tax depreciation exceeds economic depreciation, an incentive is created for investments in depreciable property for tax reasons alone (President's Tax Proposals, 1985).

METHODOLOGY

The methodology used in this research is the logical application of tax policy to depreciation for the purpose of controlling inflation, starting from the inception of such legislation in 1913. The relationship between tax policy changes and inflation is being examined on the basis of tax laws, administrative rules and regulations, court decisions, and the opinions of economists and tax experts. Wherever possible, previous empirical studies showing the effects of tax policy changes on investment and inflation have been used to support the arguments put forth below.

A tax system that attempts to control inflation will be more effective than a system that seeks to alleviate the effects of inflation through across-the-board tax cuts. The inflation rate essentially depends on productivity trends, which can be improved by reducing the cost of capital and stimulating investment in productive economic activities. Economic activities which tend to stimulate productivity growth are classified as productive, and those which do not substantially contribute to productivity growth are categorized as non-productive activities. In general, the primary non-productive sources of income are passive investments, which may include investments in tax sheltered activities and investments in other activities where the primary source of income is due to inflationary gains. Congress realized the distinction between these activities and, as a result, added I.R.C. section 469 in 1986, classifying economic activities as "active" or "passive" based upon their anticipated impact on investment. According to a report of the Senate Finance Committee in that year:

> *"The prior law of tax favored assets has harmed the economy generally, by providing a non-economic return on capital for certain investments. This has encouraged a flow of capital away from activities that may provide a higher pre-tax economic return, thus retarding the growth of the sectors of economic with the greatest potential for the economy" (Senate Report no. 313, 1986). It is evident from this statement that Congress had already recognized the potential impact of tax policy on inflation and productivity growth.*

Evaluation of the Depreciation System

A historical overview of the depreciation system shows that Congress has tried to ensure that depreciation allowances would reflect economic reality, while simultaneously stimulating investment through the use of accelerated cost recovery methods. However, the implementation of ACRS did not provide an effective cure for inflation, and did not promote increased investment as expected. Various studies have attempted to assess the effect of accelerated depreciation as an investment incentive (Barry P. Bosworth, 1985, and Charles W. Swenson, 1987). Those studies did not conclusively establish the real impact of tax incentives on capital investment through depreciation. Most studies have concluded that tax incentives may have had a role in capital investment, albeit a far less significant one than was commonly believed.

Expressing his doubts on the effectiveness of the accelerated cost recovery system to promote economic growth, Charles W. Swenson commented:

> *"Although not neutral on a macro basis, ACRS will significantly correct for under-depreciation in many industries. Unfortunately, it will overcompensate for under-depreciation in capital intensive industries. These disproportionate benefits during inflationary periods will result in large direct shifts in capital across industries, which indicate the horizontal inequity of ACRS. This effect may be exacerbated by indirect wealth transfer to more tax-favored industries. Both of these shifts in capital would result in economic inefficiency and a deadweight loss to the economy. It is ironic that ACRS was created to promote economic growth through capital formation, yet its deadweight loss to economy may have diminished or offset any welfare gain through economic growth." (Charles W. Swenson, 1987).*

In fact, the relative lack of capital investment for nearly two years after the enactment of ACRS in 1981 provides evidence that capital formation did not significantly increase due to the policy of accelerated depreciation. Table 8 measures the amount of savings in the U.S. correlated with the Flow of Funds Data from 1953-1989 as a percentage of GNP.

Table 8: Savings in the U.S. Correlated with Flow of Funds Data (as a Percentage of GNP)

Period	Household Savings	Corporate Savings	Private Savings	Government Savings	Net National Savings
1953-1961	5.6	1.9	7.5	-9	6.7
1962-1973	5.6	2.2	7.8	-5	7.3
1974-1979	5.6	2.7	8.3	-1.5	6.8
1980-1984	5.5	1.6	7.0	-2.9	4.1
1985-1989	3.9	1.4	5.2	-2.9	2.3

Source: Constructed from the Federal Reserve Board, New York Quarterly Review *(Winter 1991), Volume 15, No 3-4. Table 8 indicates that household savings, corporate savings, government savings, and net national savings did not improve due to the implementation of the Accelerated Cost Recovery System and the Modified Accelerated Cost Recovery System. Instead of the anticipated improvement in savings, the actual rate of savings decreased after 1980.*

Empirical evidence suggests that businesses choose depreciation methods to increase reported earnings. Firms that use accelerated depreciation methods show higher levels of capital investment (A.R. Beeren, 2013), and many firms depreciate assets more aggressively for financial reporting purposes than they do for tax reporting. Accelerated depreciation methods lack comparability with other businesses and with financial statement users (Thomas R. Noland, 2010). Depreciation methods influence firms' capital investment decisions; however, it is possible that the choices firms make for financial reporting purposes may reflect non-value maximizing decisions (Scott B. Jackson, 2008), which might not promote investment in productive economic activities. Furthermore, accelerated cost recovery methods widen the gap between tax depreciation and economic depreciation. In an attempt to provide realistic depreciation deductions, the Tax Reform Act of 1986 modified and restricted the more liberal methods of depreciation. While the MACRS introduced by the Tax Reform Act of 1986 is a step in the right direction, it is not a permanent cure. As shown in Table 9, the recovery periods of many classes of property under MACRS are the same, whereas the rates of economic depreciation are different.

Table 9: Economic Rates of Depreciation for Different Assets

Asset Class	Estimated Economic Depreciation Rate	Accelerated Cost Recovery System Rates	Modified Accelerated Cost Recovery System Rates
Furniture and Fixtures	0.110	0.20	0.143
Fabricated Metal Products	0.092	0.20	0.143
Engines and Turbines	0.079	0.20	0.143
Tractors	0.163	0.20	0.20
Agricultural Machinery	0.097	0.20	0.143
Construction Machinery	0.172	0.20	0.143
Mining and Oil Field Machinery	0.165	0.20	0.20
Metal Working Machinery	0.123	0.20	0.143
Special Industry Machinery	0.165	0.20	0.143
General Industrial Equipment	0.123	0.20	0.143
Office and Computing Machinery	0.273	0.20	0.143
Service Industry Machinery	0.165	0.20	0.143
Electrical Machinery	0.118	0.20	0.143
Trucks, Buses, and Trailers	0.254	0.20	0.20
Autos	0.333	0.333	0.20
Aircraft	0.183	0.20	0.20
Ships and Boats	0.075	0.20	0.10
Railroad Equipment	0.066	0.20	0.143
Instruments	0.150	0.20	0.143
Other Equipment	0.150	0.20	0.143
Industrial Buildings	0.036	0.53	0.27
Commercial Building	0.025	0.53	0.27
Religious Buildings	0.019	0.53	0.27
Educational Buildings	0.019	0.53	0.27
Hospital Buildings	0.023	0.53	0.27
Other Non-farm Buildings	0.045	0.53	0.27
Railroads	0.018	0.67	0.05
Telephone and Telegraph	0.033	0.67	0.05
Electrical Light and Power	0.030	0.67	0.05
Gas Facilities	0.030	0.10	0.67
Other Public Utilities	0.045	0.10	0.67
Farm Structures	0.024	0.53	0.05
Mining, Shafts and Wells	0.056	0.20	0.20
Other Non-building Facilities	0.029	0.53	0.27
Residential Structures	0.015	0.53	0.275

Source: Constructed from Don Fullerton/Yolanda K. Henderson/ James Mackie; adapted from Compendium of Tax Research*, Department of the Treasury, p.179 (1987). This table indicates that the estimated rates of economic depreciation for various assets used in business aredifferent than the tax depreciation rates prescribed by the Accelerated Cost Recovery System and the Modified Accelerated Cost Recovery System. In fact, tax depreciation rates widened the gap between economic depreciation and tax depreciation.*

RESULTS AND DISCUSSION

Congress has made extensive use of accelerated depreciation to stimulate investment in desired channels and to promote economic growth. Previous research studies do not conclusively prove the success of accelerated depreciation in stimulating investment in desired channels. The artificial service lives prescribed by the Accelerated Cost Recovery Systems, unrelated to assets' actual useful lives, undermine the accuracy of real depreciation while encouraging firms to allocate assets to non-productive economic activities solely for tax benefits. These activities have negative impacts on capital formation and do not serve to control inflation (Benshakr et. al. 2009). According to a 1984 Treasury Department report:

> *Tax liabilities should be imposed on the basis of real economic income. In the case of investment in depreciable property, measurement of real economic income requires an allowance for the property's economic depreciation. If that allowance is understated income from the investment is overtaxed and a tax disincentive is created which impairs capital formation and retards the economy's productive capacity. By the same taken, overstating depreciation and thus understating income creates an artificial incentive for one form of investment over another, discriminates among companies within the industry, and encourages nonproductive, tax-motivated investment activity. (Treasury Proposal, vol. 2, 1984)*

Improved accuracy in income measurement would result if all firms began to use the straight-line depreciation method. Straight-line depreciation provides a reasonable estimate of the decline in an asset's value and allocates the cost of investment systematically over the assets' useful life. Most U.S. firms use the straight-line depreciation method for financial reporting purposes; a 2009 study found that 79.53 percent of businesses used straight-line depreciation methods, while 20.4 percent of the businesses used accelerated depreciation (Jackson et. al., 2009). The current straight-line method of depreciation, however, is not free from defects. It does not take into account the impact of inflation on depreciation. The real value of depreciation deductions drastically declines during periods of high inflation, which requires an adjustment in the depreciation allowance to compensate taxpayers. Many economists suggest the income tax code should provide provisions for indexing depreciation to the rate of inflation (Joseph J. Minarik, 2014). If the straight-line method, indexed for inflation, were to be used uniformly, it would avoid the distortion that results from investment decisions based on tax considerations alone.

Table 10: Example of Straight-Line Depreciation, Indexed for Inflation

Year	Straight-Line Depreciation	Rate of Inflation	Indexed Depreciation
1	$2,000	4%	$2,080
2	2,000	3%	2,060
3	2,000	2%	2,040
4	2,000	5%	2,100
5	2,000	6%	2,120
Total	**$10,000**		**$10,400**

Table 10 shows a hypothetical example of straight-line depreciation indexed for the rate of inflation. The amount of indexed depreciation shown is more than the historical cost of the property. The taxpayer receives a substantial tax savings due to a decrease in taxable income. The difference of $400 between the current method of straight-line depreciation and the indexed straight-line depreciation represents the effect of inflation on depreciation.

CONCLUSION

We conclude that the current accelerated cost recovery methods are not as effective in stimulating investment in productive activities, which is essential to promote economic growth and thus control inflation. Congress has already acknowledged a distinction between activities that tend to stimulate growth and those "passive" activities that do not do so, with a 1986 Senate Finance Committee Report stating that "the prior law of tax favored assets has hampered the economy generally, by providing a non-economic return on capital for certain investments. This has encouraged a flow of capital away from activities that may provide a higher pre-tax economic return, thus retarding the growth of the sector of economy with the greatest potential for expansion" (S. Rep. No. 313, 1986).

Given this distinction, the determining factor that classifies an activity as productive or non-productive should be the impact of that activity on productivity growth. The first seeds of this concept were first sown when Congress added § 469 of the Internal Revenue Code, providing rules for passive activities (IRC, Section 469, 1986). These rules attempt to discourage passive, non-productive activities by preventing taxpayers from using losses from those activities to offset income from active sources. Discouraging passive investments result in the more efficient deployment of capital, which in turn promotes productivity growth. Based upon this research, the following changes in the tax code ought to be proposed:

The rate of depreciation allowed for tax purposes needs be equal to the actual economic rate of depreciation. In practice, it is difficult to calculate the true economic depreciation of each capital asset; however, a reasonable allowance for depreciation may be calculated objectively (Congressional Budget Office, 1985). Congress has unfettered discretion to determine the parameters of reasonable allowance under various circumstances. The absence of fixed criteria to determine a reasonable rate of depreciation tends to create uncertainty in the system. Further research is needed to find a satisfactory uniform method for calculating reasonable depreciation. The straight-line depreciation method, indexed for inflation, should be treated as real economic depreciation until a reliable method is devised to measure economic depreciation (Venus C. Ibarra, 2013). Straight-line depreciation, indexed for inflation, best reflects the original intention of Congress in creating the depreciation system, and would provide a reasonable estimate of actual depreciation expense as this method equally allocates the costs of assets over their useful lives (Ben-Shahar et. al. 2009).

All economic activities do not equally stimulate desired investment and promote capital formation. Therefore, research is recommended to better classify economic activities as productive or nonproductive. The classification of any given activity should be based upon the impact of the activity on investment, employment, and economic growth, as opposed to the criteria of material participation in the activity by taxpayers under IRC Section 469 (which is required to separate active activities from passive activities) (I.R.C. Section 469,(e) (i) 1986).

Congress introduced the Investment Tax Credit in 1962 to subsidize expenditures by firms for promoting investment in certain desired activities, and to stimulate economic growth. The credit was finally suspended by the Tax Reform Act of 1986 (IRC §§ 38, 46-48, 1986) on the grounds that the investment tax credit did not provide substantial financial assistance and therefore did not stimulate economic growth. It is recommended that a modified investment tax credit should be reinstated for economically-productive activities only, in order to stimulate investment (Survey et. al., 1976 and Martin Feldstein et. al. 1979). The combination of the straight-line depreciation method, indexed for inflation, and a modified investment tax credit would help provide a truly reasonable method for compensating depreciation, and would help control inflation by stimulating investment in productive economic activities.

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ASSESSMENT OF GOING CONCERN FOR THE ITALIAN LISTED COMPANIES: AN EMPIRICAL STUDY

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ABSTRACT

The research has a dual purpose. The first is to investigate the going concern assumption for Italian listed companies by analyzing the contents of audit reports issued by the independent auditors. We examined meeting the following criteria: a) all the companies listed on the Italian Stock Exchange; b) excluding foreign companies c) and included an auditor report on the 2012 consolidated financial statements. The results show that 80% of Italian listed companies have no issues related to business continuity. The remaining 20% showed significant problems. The second purpose is to analyze the trend of the going concern assumption for Italian listed companies. We compare going concern figures between 2009 and 2012.

JEL: M41, M42

KEYWORDS: Going Concern, Audit's Opinion

INTRODUCTION

The economic crisis affected has the entire world since 2008. The crises is ongoing in Italy. Emerging economies have slowed their growth. Mature economies have entered a downward spiral that led to a drastic deterioration of macroeconomic indicators. According to data published by ISTAT in 2012 (www.istat.it) among the major European economies, Italy has experienced the most pronounced GDP decline. The Italy decline in GDP of 6.3% compared to an average of around 3.5% in other European countries. The international economies, especially Asian countries, are able to cope better with the crisis despite a slowdown in the growth of their GDP. In this difficult economic environment it is essential that stakeholders receive accurate information from companies on their health status and their ability to continue the business and safeguard the going concern assumption. The problem of verifying existence of the assumption of going concern is particularly relevant in the current period. This holds true for both Italy and other nations. The standardization of accounting standards has allowed harmonization of the procedures for financial statement preparation. In this research, we analyze the going concern assumption as a fundamental principle in the provision of financial statements. We use the Going Concern Audit's Report of Italian listed companies to attest that many Italian listed companies have significant problems related to business continuity. Furthermore, a comparison over time between 2009 and 2012, using a research issued by Italian Chartered Accountants Association, suggests increasing problems and doubts related to business continuity. The remainder of the paper is organized as follows. The next section describes literature related to the scope of this research on the going concern assumption. Next we describe and discuss the data of analysis and in the final section provide some concluding comments.

LITERATURE REVIEW

The assumption of going concern has ancient origins. Only in recent years, due to the bad conditions of the world economy, has it become a hot topic. The first research on business continuity dates back to Laurance R. Dicksee (1892) and then to H. R. Hetfield (1909). Over the years, many studies were published that analyzed differences contained in the regulations of various countries for the assessment of going concern. In particular, the research of J. E. Boritz (1991), R. D. Martin (2000), L. Collins (1992), A. Kausar, R.J. Taffler, C. Tan (2008), M. Ogneva, K. R. Subramanyam (2007) show that despite efforts made by international institutions, in an attempt to harmonize the standards, there are still substantial differences. Common standards for assessment of the going concern assumption in the U.S.A remain more methodological compared to other European countries including Germany, France and the United Kingdom.

Other authors Robinson D. (2008), K. Menon, D.D. Williams (2010), P.J. Carey, A. Marshall, G. and B T.O' Connell (2008), G. Atkinson (2009), I. G. Basioudis, E. Papakonstantinou, M.A. Geinger (2007), highlight the relationships between the Going Concern Audit's Opinion and investors decisions. The going concern assumption is universally understood and accepted by accounting professionals, however it has never been formally incorporated into U.S GAAP. In 2011 after the publication of the FASB Exposure Draft on Going Concern Assumption emphasized the major management responsibility for business continuity. Some studies W. Hahn (2011), D. L. Lindherg (2011) have been published showing the update of the FASB is necessary because provisions on going concern for the U.S. GAPP are still too different than other international standards.

DATA AND METHODOLOGY

In the Italian system, the main standard rules relating to going concern are contained in: 1.) Civil Code, Article 2423-bis, 2.) OIC. No. 5 - Financial Statements for liquidation's company, 3.) No OIC.11 - Financial Statements, objectives and postulates, 4.) IAS 1 - Presentation of Financial Statements, 5.) Auditing Standard No. 570 - Going Concern, 6.) The Bank of Italy / Consob / Isvap 2 of 6 February 2009, 7.) Consob Communication no. 9012559 dated 6 February 2009.

Article 2423-bis of the Civil Code entitled "Basis of preparation of Financial Statements" states: "In preparing the financial statements, the following principles should be observed: the evaluation of the financial statement must be made prudently and in a going concern basis, as well as considering the economic function of the assets and liabilities;"

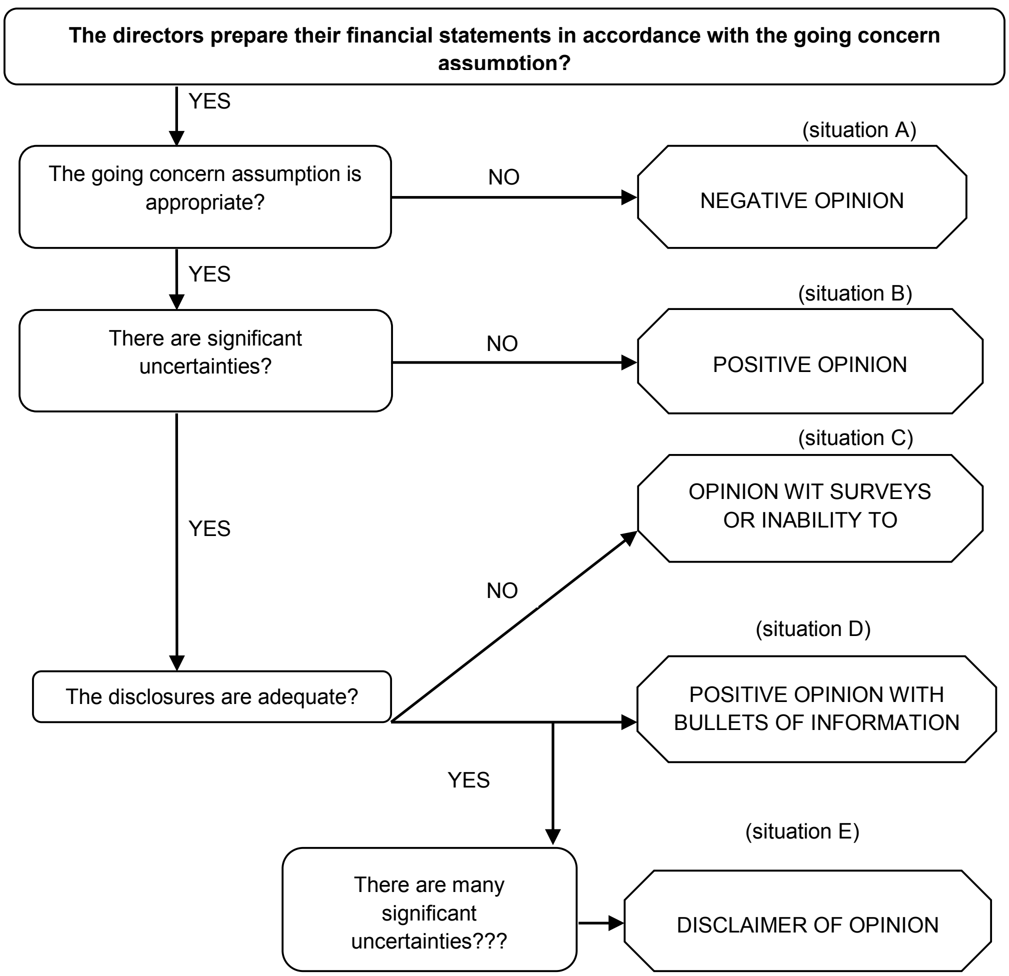
The OIC 5, entitled "Financial Statements for liquidation's company", in paragraph 7 defines a company in continuity ("going concern") as "company functioning and intended to continue the business for at least twelve months after the date of the balance sheet." The OIC 5, unlike the provisions set out under the Civil Code, defines a time-frame of 12 months referring to evaluate business continuity.

The OIC 11, entitled "Financial Statements - purpose and postulates," interprets and describes the main postulates and principles for annual financial statements, including the going concern assumption. Among the international accounting standards, there are numerous references to assumption of going concern. First, the principle of going concern is included in the IFRS Framework as an "underlying assumption" for the preparation of the financial statements. The theme is explored in IAS 1, Paragraphs 23 and 24 entitled "Presentation of Financial Statements." This document states: "In the process of preparing financial statements, management shall make an assessment of the entity's ability to continue as a going concern ..."

In estimating the assumption of a going concern, management takes into account all available information about the future, which must be at least, but not limited to, twelve months after the date of the financial statements. The grade of consideration depends on the circumstances related to each specific company. Three main considerations emerge by reading the paragraphs: a) In preparing the financial statements, management must assess whether conditions for the company to continue activities are present. These assumptions must be properly documented in financial reporting. b) The financial statements must be drawn up with a view to going concern. If financial statements are not prepared on a going concern basis, this fact shall be disclosed, together with the basis on which it was prepared and the reason why the entity is not regarded a going concern. c) The period of twelve months is not to be considered a limit for the assessment of going concern, but as a minimum threshold of reference.

International auditing standards show certain uniformity on review of the principle of going concern. The ISA No. 570 Going Concern, led to a progressive homogeneity on topics covered and the procedures the audit must follow in its assessments. Review of the going concern basis was introduced and pursued by the Big Four. This made possible the homogenization of rules explained in the "guides" that auditors must follow. The purpose of ISA No. 570 is to establish standards and provide guidance on the auditor's responsibility for the correctness of the going concern assumption used as a basis for the preparation of financial statements. Based on considerations made by the directors with regard to going concern, the auditor expresses his opinions in the audit report on the financial statements. ISA 570, in the section "Conclusions of the review and drafting of the auditor's report," explains the different types of auditor's opinion which are summarized in Figure 1.

Figure 1: Auditor's Opinions on Going Concern Assumption



This figure shows the different audit opinions on Going Concern Assumption according ISA No. 570.

Analysis of situations that may occur. Situation A.) The auditor must describe the reasons why the use of the going concern assumption is not appropriate (Negative or Qualified Opinion). Situation B.) In this case no reference to business continuity will appear in the report (Positive or Unqualified Opinion). Situation C.) This hypothesis are planned and regulated by the Standard on Auditing 570 according to paragraphs 37 and 38,: "In certain circumstances [...] the auditor may find it necessary to ask management to make or extend its assessment. If management refuses, it is not the auditor's responsibility to correct the lack of such analysis. In this case, it may be appropriate for the auditor to issue a report with an opinion other than unqualified because it may not be possible to obtain sufficient and appropriate audit evidence about the correctness of the going concern basis in preparing the financial statements. In the absence of feedback from management, the auditor may not be able to assess the existence of events or circumstances that cast significant doubt about the going concern of the company, or the existence of plans to cope with such events or circumstances or to assess other mitigating factors. In these cases, the auditor should express a qualified opinion for limitations to the review process or declare the impossibility of expressing an opinion. If the refusal by management to make or extend the evaluation of going concern constitutes a deviation from the applicable financial reporting framework applicable to the financial statements, auditors should disclose this fact in its audit report in the same paragraph in describing the limitations to the review process. They should express a qualified opinion for limitations to the review process, or declare it impossible to make a judgment".

Situation D.) According to the auditor's opinion, there is a significant uncertainty, but the going concern assumption is considered appropriate. The auditor has verified the budget adequately describes main events and circumstances that raise doubts about the business continuity and management's plans to deal with such events. The budget also shows clearly that a material uncertainty exists related to events or conditions that raise significant going concern doubts and therefore the firm may not be able to realize its assets and discharge its liabilities in the normal course of business. The audit opinion will emphasize these aspects to attract the reader's attention. Situation E.) Regarding this circumstance, the Standard on Auditing. 570, paragraph 33, states: "When the going concern assumption is subject to multiple relevant uncertainties, the auditor may conclude, in extreme cases, not to be able to express an opinion on the financial statements."

In 2011, the ODCEC (Italian Association of Chartered Accountants) carried out research relating to the business continuity assumption of Italian listed companies. They analyzed the Audit's Report on financial statements dated 2009. In accordance with the standards, the requirement to assess whether an entity is a going concern should rest with the management team. Independent auditors must assess and analyze: 1.) The process followed by management in assessing business continuity, 2.) The assumptions underlying the process, 3.) Management's plans for future action. The auditor's responsibility is to obtain appropriate audit evidence about the appropriateness of management's use of going concern assumption in the preparation of the financial statement and to conclude whether there is uncertainty about the entity's ability to continue as a going concern. Each Audit's Report has been classified according to the five possible opinions 1.) Unqualified Opinion, 2.) Unqualified Opinion with Emphasis, 3.) Qualified opinion, 4.) Negative opinion, 5) Disclaimer opinion. The research results are summarized in Table 1.

Table 1: The Going Concern Italian Listed Companies Opinions Dated 2009

Opinion	Number	%
Unqualified Opinion	254	87%
Unqualified Opinion with Emphasis	24	8%
Qualified opinion	1	0%
Negative opinion	2	1%
Disclaimer opinion	9	3%
Not available	1	0%
Total	**291**	**100%**

This table shows results from 280 Italian listed companies in 2009. For 250 firms the going concern assumption is affirmed. For 37 firms there are concerns regarding going concern status.

We performed the same analysis on 2012 financial statement in order to allow a comparison over time between the two years. The research investigates Italian Stock Exchange listed companies including 272 listed companies in 2012, as reflected on the Italian stock exchange website (www.borsaitaliana.it). We exclude foreign companies listed in Italy (for their exclusion we analyzed the registered office of the parent company). We include only one observation when there are multiple share listings for a single company. The sample was restricted to firms having Audit Reports.

RESULTS

From Table 2 we deduce a.) Some 200 companies have a fully unqualified opinion (74% of the total). b.) another 50 companies have an unqualified opinion with emphasis (18% of the total). This category can be further divided in two types: those with emphasis on the going concern assumption (35 companies, 13% of the total) and those with emphasis related to other topics (15 companies, 5% of the total). The companies with explicit emphasis on going concern assumption are shown in Table 3. Table 4 shows listed companies highlighted unqualified audit report with emphasis on other topics. Table 5 shows listed companies with highlighted disclaimer of opinion.

Table 2: The Going Concern Italian Listed Companies Opinions dated 2012

Opinion	Number	%
Unqualified Opinion	200	74%
Unqualified Opinion with emphasis	50	18%
Qualified opinion	0	0%
Negative opinion	0	0%
Disclaimer opinion	12	4%
Not available	10	4%
Total	**272**	**100%**

This table shows results of the analysis of 272 Auditors Reports to the Financial Statements dated 2012. For 200 companies listed there are problems of business continuity

For these companies, there are significant doubts about the entity's ability to continue as a going concern for a reasonable time period, not to exceed one year beyond the date of financial statements being audited. In these cases, the external auditors have considered positively management views on the issue of going concern, inviting the stakeholders to consider carefully the section of financial statement where the topic is discussed.

Table 3: Listed Companies Highlighted Unqualified Audit Report with Emphasis on Going Concern

A.S. Roma	Eukedos	Mediacontech	Primi Sui Motori
Aedes	Fintel Energia Group	Molmed	Rcs Mediagroup
Bastogi Spa	Gabetti	Moviemax	Screen Service
Borgosesia	Hi Real	Nova Re	Sintesi
Brioschi	Imvest	Olidata	Snai
Cape Live	Industria E Innovazione	Pierrel	Stefanel
Ceramiche Ricchetti	Invest E Sviluppo	Pininfarina Spa	Telecom Italia Media
Chl	K.R.Energy	Pms	Tiscali
Cobra	Maire Tecnimont	Prelios	

The table shows the companies that according to Audit's Opinion highlight doubts on going concern assumption

The topics on which to turn the requests for information are mainly: the related party transactions, ongoing litigation, changes in accounting standards compared with the previous year and assessment methods of fixed assets. For these companies according to the auditors there aren't problems of business continuity.

c) The companies for which it has been notified the impossibility to express an opinion by auditors (Disclaimer of opinion) are 12, corresponding to the 4% of all companies analyzed.

For these companies there are "significant and substantial" evidence of events or conditions that may cast doubt on the entity's ability to continue as a going concern. These situations led the auditor to express the impossibility an of audit opinion. For these companies the going concern assumption is seriously compromised. d) For 10 companies, about 4% of the total, it was not been possible to obtain the Audit Opinion because financial statements dated 2012 are not available. Table 6 shows companies belonging to this category and the causes that didn't allow to obtain the audit's report.

Table 4: Listed Companies Highlighted Unqualified Audit Report with Emphasis on Other Topics

Acea	Falck Renewables	It Way
Acque Potabili	Fiera Milano	Mc-Link
Autostrade Meridionali	Finmeccanica	Prysmian
Banca Mps	First Capital	S.S. Lazio
Dea Capital	Impregilo	Vita Società Editoriale

The table shows the companies that according to the audit's reports highlight emphasis on other topics

Table 5: Listed Companies Highlighted Disclaimer of Opinion

Antichi Pellettieri	Dmail Group
Beghelli	Eems
Biancamano	Ikf
Cdc	Pramac
Ciccolella	Uni Land
Cogeme Set	Zucchi Spa

The table shows the companies without an audit opinions

For Montefibre and Value Italian Holding we were not able to obtain the financial statement report. The documents appear neither on the company website nor on the Italian Stock Exchange website. We assume independent auditor's report is not positive. This hypothesis is strengthened by the fact that for previous annual reports the auditors communicated the impossibility of making an opinion. For research purposes we considered it appropriate to insert in the sample the companies just mentioned, as they were all operating and listed on the Italian Stock Exchange in the in 2012.

Table 6: Listed Companies without Audit Report Available

Aicon	bankrupt company dated 21/01/2013
Aion Renewables	bankrupt company dated 18/03/2013
Arena	creditors agreement procedure from 08/08/2012
Banca Popolare di Spoleto	extraordinary administration procedure from 12/02/2013
Crespi	liquidation procedure from 29/04/2013
Rdb	extraordinary procedure from 10/09/2012
Seat Pagine Gialle	creditors agreement procedure from il 28/06/2013
Sopaf	Liquidation procedure from 01/07/2013
Montefibre	Financial Statement not available either on the company's website or on the website of the Italian stock exchange
Valore Italia Holding Di Partecipazioni	Financial Statement not available either on the company's website or on the website of the Italian stock exchange

The table shows the companies without an Audit's Opinion and the reasons. The data show companies whose activities have been extraordinary procedures such as bankrupt, creditors arrangement or liquidation

CONCLUDING COMMENTS

Table 7 shows the results and temporal comparison between the two researches in absolute and relative terms. The number of listed companies on the Italian Stock Exchange has declined over the from 2009-2012. This shows that Italian companies are reluctant to list on the stock exchange. Changes in the number of listed companies in the three years considered, the comparisons will be made on the deviations. Audit Reports with unqualified opinion decreased of 10% while Audit Reports with unqualified opinion with emphasis increased by 10%. The results of ODCES research do not provide details related to unqualified opinions with emphasis if they refer to going concern or other aspects. We assume these two variations reflect a worsening of the situation of Italian listed companies on their business continuity. Another significant negative aspect is the increase of companies without financial statements. We aggregated the data to obtain a single parameter analysis on going concern assumption as shown in Table 8.

Table 7: Final Aggregate on Going Concern Assumption

Opinion	2012	%	2009	%	Δ
Opinion unqualified	200	74%	254	87%	-14%
Opinion unqualified with emphasis	50	18%	24	8%	10%
Qualified opinion	0	0%	1	0%	0%
Negative opinion	0	0%	2	1%	-1%
Disclaimer opinion	12	4%	9	3%	1%
Not available	10	4%	1	0%	3%
Totale	**272**	**100%**	**291**	**100%**	

This table shows a comparison between the data for 2009 and 2012. Companies with Unqualified Opinion with emphasis are 50 in 2012 increased compared to those of 2009. The companies with Disclaimer Opinion and Without Opinion available in 2012 are increased compared to 2009 too.

The first group includes all companies with an unqualified opinion and with an unqualified opinion with emphasis related to other topics not related to the going concern assumption. The second category includes companies for which the auditors issued an unqualified opinion with emphasis on going concern. The third group includes companies for which the auditors manifested the impossibility to express an opinion because there are conditions and events that indicate substantial doubt about the entity's ability to continue as a going concern. Finally, the fourth group includes the two companies that declared bankrupt (Aicon and Aion Renewables) and two in the process of liquidation (Crespi and SOPAF).

In conclusion we note that about 80 percent of Italian listed companies at the end of 2012 did not have business continuity problems, a deterioration compared to the 2009 data. Apparently the Italian economy situation is reflected the performance of listed companies.

Table 8: Final Aggregate on Going Concern Assumption

Categoria	Numero	%
Unqualified Opinion and Unqualified with Emphasis on other topics	215	79%
Opinion with Emphasis on going concern	35	13%
Significant and substantial doubt to the entity's ability to continue as a going concern	18	7%
Companies gone out of business activities	4	1%
Totale	**272**	**100%**

The table shows the final aggregate on going concern assumption. Companies with problems on Going Concern assumption are 53 of which 35 with Opinion with emphasis on going concern and 18 with significant and substantial doubt to the entity's ability to continue as a going concern

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NO KENYAN LEFT BEHIND: THE MODEL OF FINANCIAL INCLUSION THROUGH MOBILE BANKING

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ABSTRACT

The importance of widespread access to suitable financial services for the populace in fostering economic vitality is well recognized. Regrettably, much of the developing world experiences a relative scarcity of crucial financial services in rural and semi-urban areas. With estimated mobile devise ownership at over 700 million in Africa, innovative banking solutions such as mobile banking offer potential channels to advance the access frontier in the banking industry. This study examines Kenya's highly successful money transfer model, M-pesa, in an effort to explore the nature and role of financial inclusiveness in stimulating economic activity. M-pesa allows ordinary Kenyans to send money across the country cheaply and reliably using mobile devises. As such, the stage appears set for a mass adoption by similarly situated countries in the region that are keen to enhance their financial services. Understanding the nature and role of economic dynamism dispensed through financial inclusiveness can be useful for policy prescription and future studies, among other things. To this end, we borrow from a combination of the ideas of velocity circulation of money and a simple diffusion model to develop a framework for empirical study.

JEL: G00, G20, E41, E42

KEYWORDS: Mobile Banking, Financial Innovation, Financial Inclusion, Money Velocity

INTRODUCTION

In much of the developing world, there is a relative scarcity of crucial financial services in rural and semi-urban areas. Ensuring availability of suitable financial services to as much of the population as possible is a requirement for economic vitality in these regions. The African Development Bank's (AfDB) 2010 estimate of over 500 million people owning mobile phones in Africa appears to favor widespread adoption of Kenya's money transfer model, M-pesa by countries keen to enhance access to financial services. M-pesa is a money transfer service, initially developed and deployed in Kenya by Vodafone, a European telecommunications giant in partnership with Safaricom, the leading Kenyan mobile operator. It allows ordinary Kenyans to send money across the country cheaply and reliably, using their mobile phones. The OECD reports that M-pesa registration estimates at some seven million customers, who are transferring an average of $2 million a day between themselves. Reports released by the Communications Commission of Kenya in the first quarter of 2012 show that Kenya's mobile penetration is at 77.2 per cent with a market share of 30.4 million mobile subscribers as of September 2012. Given the above indications, a deduction can be made to the effect that new solutions will offer channels to advance the access frontier in the banking industry as more Kenyans are brought into banking solutions.

At this point, a working definition of the meaning of mobile banking is appropriate: Generally, if a bank is not directly involved in the instrumental gratification of a service offered, it is usually called a "mobile payment" (Cruz, Pedro, et al, 2010). Financial services that may be delivered through the mobile channel are not different from those delivered through conventional banking channels in some respects, and can therefore be viewed as a form of branchless banking. Its popularity with customers and retailers alike in both developing and emerging markets is well documented. The case of Kenya, which has caught the attention of other mobile phone operators on the African continent, is of particular interest. Many view it as the model to be replicated throughout the continent as more countries seek to boost access to financial services among citizens.

This study explores the nature and role of economic dynamism dispensed through branchless banking innovations in Kenya with the aim of shedding more light and developing a useful model framework for empirical investigation among other things. A review of literature follows the introduction. In particular, the literature discusses the subject of branchless banking in the context of suitability of innovations and linkages to economy. A methodology section follows. In it, we conceptualize a model framework for empirical analysis. We conclude with a discussion of future research, potential policy implications in the context of model deployment, and limiting factors of the study.

LITERATURE REVIEW

Examining Suitability of Branchless Banking Innovations

The experience of Kenya with M-pesa can serve to illustrate mobile banking's potential for generating efficiencies in the financial economy. Low cost, money security, speed, and user-friendliness are among such efficiencies. Generally, mobile banking costs to the customer are hardly more than the transaction fee. The usual added charges and other cumbersome details associated with conventional banking scarcely exist, or are absent altogether. Soon after the launching of Kenya's M-pesa, the then Safaricom CEO Michael Joseph was quoted by Business Daily stating: "M-pesa is the first product in the world that allows the unbanked, with no banking details, no registration, no bank account, no credit card, to do banking." We can therefore appreciate how Kenya's M-pesa has steadily gained competitiveness in the money transfer market against customary channels, and is leading to enormous changes in the organization of economic activity, family relations, risk management and mitigation, among other things (Mbiti and Weil, 2011).

For the purposes of this study, the case of Kenya is particularly meaningful because it represents the experience of many underdeveloped regions, particularly those in sub-Sahara African where significant sections of the population rely on informal finance solutions, which are often highly inconvenient, invariably unsafe, and largely disconnected from the rest of the world. According to Paul Makin of the OECD, the United Nations Department of Economic and Social Affairs (Undesa) estimates that in Africa alone, there are 300 million (approximately the entire U.S. population) reachable adults with no current access to formal financial services. Ignacio Mass, (2009) asserts that financial markets are quite simply failing to meet the needs of majority of the society in such regions, who are typically poor and live in rural areas. He suggests that any viable mitigating solution must prioritize keeping fixed costs per customer extremely small and reducing unit transaction costs.

In effect, Kenya's experimentation with M-pesa has taken banking transactions out of bank branches and into retail stores in more neighborhoods and villages. The product concept is simple, but nonetheless powerful. Users can transfer money from their mobile phones quickly, safely, and across great distances to other mobile phone users. A bank account is not necessary. Users only need to register with Safaricom for an "M-pesa account." However, recipients need not have an M-pesa account. Ignacio (2009) identified key elements that constitute the platform for branchless banking: (i) a retail network, composed of a collection of retail outlets where transactions are originated, (ii) the payment network, which aggregates the transactions from the collection of retail outlets and routes them to the appropriate issuer, and (iii) the account platform which manages the service logic by authorizing individual transactions and maintaining the value accounts. These elements are all evident in the M-pesa model, and present key tradeoffs that providers need to face. Ignacio (2009) adds that an understanding of the economic drivers helps establish roles of the value chain and types of partnerships that improve the likelihood of achieving the necessary scale, and ensuring that the service can be delivered at an end-to-end transaction cost that is affordable to poor customers.

Evidence suggests that each market evolves slightly differently based on distinct customer needs and other unique considerations, even though service delivery is generally enabled by the core set of elements described above. Yet it is worth noting that branchless banking models follow the same underlying functionality to move funds conveniently for users (Mroueh, 2013). For example, in developing nations such as Kenya, branchless banking is mostly tailored to facilitate person-to-person payments. In more advanced economies, branchless banking is generally richer and largely convenience situated; often includes checking and maintaining account balances or making purchases electronically.

Linking Financial Innovation Solutions to Economic Activity

It can be taken for granted that economic competitiveness and growth are compromised in markets where information is poor, scarce, and inefficiently communicated (Geertz, 1978). Consider the importance of timely access to knowledge of commodity prices. This can be hard to obtain in remote villages with limited telephone connections. The effect is a restricted market access for traders (Lars-Hendrik and Waverman, 2001). Mobile services can effectively relieve such restrictions by replacing physical transportation or specific transactions. In addition, mobile phone technology aids the increased flow of information and can potentially result in efficient commodity prices. Mbiti and Weil (2011) cite studies by Jensen (2007) and Aker (2010) which found that the introduction of mobile phones reduced price dispersion in fish markets in India and grain markets in Niger respectively. Transacting with mobile services can also generate a personal record that can act as a basis for assessing creditworthiness and accessing micro-loans or other financial services that are critical for a widespread vibrant economic activity. Pioneering projects in India, the Philippines, or Kenya that focus on domestic and international remittances have shown the way (Comninos et al. 2008).

Farmers in Kenya continue to enjoy benefits accorded by mobile banking since the adoption of M-pesa. According to a 2011 IRIS Report by Nagarajan and Haas, improvements in food security emerged as one of the four major effects of M-pesa. The connection between food security and economy is understood. Given the unpromising report by USAID (2010) on Kenya's food security situation in which recurrent seasons of failed or poor rains, sustained high food prices, environmental degradation, outbreaks of disease, and flooding are cited as causes, one can readily appreciate the significance of M-pesa's role towards improving food security and the resultant economic implications. Though the link is not straightforward, it nonetheless helps create an environment conducive to vibrant economic activity via aiding time-sensitive farming activities. The effects on Kenya's food security are noticed in improved food production, and in access to, and consumption of diversified foods among the households that receive remittances through M-pesa (USAID 2010).

Other M-pesa effects with a more direct impact on economic activity revolve around money circulation, transaction ease, and security of money (Nagarajan and Haas, 2011). M-pesa account holders can convert cash into "e-money" through a Safaricom dealer, and then follow a simple menu of instructions on their mobile phones to make payments through their accounts. Users can withdraw or deposit funds at anyone of more than 20,000 outlets of a strong agent network. A 2011 Business Today report estimates the network to be 20 times the number of existing bank branches in Kenya. Thus, M-pesa is more than simply a money transfer mode. Its pseudo checking account separates it from many similar products. In a country where an estimated 60 percent of the adult population does not use formal banking services, the implications on the velocity of transactions can be profound. For instance, by some accounts, a quarter of Kenya's GDP is processed on M-pesa. A 2010 AfDB Report linked M-pesa to increases in transactions. The bank believes that the efficiency and near universality of M-pesa has greatly increased the speed with which money moves through the Kenyan economy. The report's findings suggest that M-pesa-induced transactions velocity may have risen by up to four times higher than the transactions velocity of other components of money. In turn, this velocity has affected supply and demand patterns. It can be argued that because Kenyans now have an easier and convenient way to transfer and spend money, more transfers and purchases are occurring.

Together, as a vehicle for financial inclusiveness, the economic dynamisms dispensed by M-pesa are considerable. Given that the volume of money supply and its speed of circulation link money to economic activity (Akinlo, 2012), in the case of Kenya, we can roughly infer that increases in money supply and its speed of circulation in the post M-pesa era are linked to changes economic activity that can be attributed to liquid money settlements. Without doubt, several other factors typically affect money supply and its velocity. Largely, monetary policy is central. For instance, it is known that the velocity of money and interest rates have a positive correlation (Mankiw, 2000). It is also advisable to be mindful that monetary policy and its transmission mechanisms are subject to the influence of external factors such as, currency exchange rate considerations, existing liquidity rules (Mihaljek 2011), prevailing economic conditions, and arrangement of financial institutions among several others. To the extent that innovations in payment methods are one of such factors, we should be alert to the mitigating potential of monetary policy. However, as a starting point, this study confines itself with the assumption that changes in in the rate of transactions occurrences following the adoption of M-pesa largely explain changes in economic activity that can be attributed to settlements with liquid money.

METHODOLOGY

If we assume that the frequency of use of M-pesa stimulates and disperses economic activity, via a velocity mechanism, we can then develop a thought process that can help us investigate the nature and role of vitality dispensed in the economy. To this end, we associate the ideas of the velocity of money concept rooted Fisher's (1911) in the Quantity Theory of Money, which supposes a direct relationship between price (P) and money supply (M). Under this supposition, increases in the amount of money in circulation result in higher prices for goods and services. The theory builds up on the following simplified definitional relationship, generally referred to as the equation of exchange. (See appendix 1 for additional notes)

$$M \times V = P \times T \tag{1}$$

Where:
M = total amount of money in circulation during a period
V= transactions velocity of money over time
P= price level associated with transactions for the economy during the period
T= index of the real value of aggregate transactions.

Therefore, we can rearrange equation (1) to express transactions velocity of money as follows,

$$V = PT/M \tag{2}$$

Given that the quantity variable under investigation assume some form of flow process, (for example money circulation and economic dynamism are expressions of some type of flow) we can adopt our thinking to employ a series of scalar quantity equations into which we will incorporate equation (2) as one of the variables.

$$\text{Disp.} = (\text{mpesa} + \Delta\text{mpesa}) \times M \tag{3}$$

Where,
Disp. = measure of diffusion of M-pesa into the economy
mpesa = number of existing registered users of M-pesa
Δmpesa = changes in number of M-pesa users over time
M = level of money supply in the economy

If we introduce a composite multiplier ø, which we assume estimates the multiplicative effect of changes in number of M-pesa accounts, we can re-write equation (3) as follows,

$$(\mathrm{m} - \mathrm{pesa} + ø\mathrm{t}) \times \mathrm{M} \tag{4}$$

Where,
t = time, say number of years

We now incorporate equation (2) into the process by taking it for granted that velocity of money describes the level of economic dynamism. We can then postulate the interactions between M-pesa adoptions over time under a given monetary regime, and economic activity using the equation below:

$$\mathrm{V} = \int_{t1}^{t2} dEcon\mathrm{V} = \int_{o}^{t=i} (m - øt)\mathrm{M}dt \tag{5}$$

Where,
V = estimate of level of economic dynamism
t = period of time
m = number of M-pesa users over time
ø = composite multiplier
M = Money supply in the economy
*Econ*V = speed economic activity

CONCLUSION

This study focused on exploring a useful framework that can be used to estimate how financial inclusion in Kenya through mobile banking has affected economic dynamism. The ideas presented are an innovative exploration that blends economic thinking and with aspects of natural science with the aim of developing a framework that can be applied to appropriate data. The study should be viewed as a broadening a conversation that is already taking place among scholars across diverse fields. We envision that using blended thought process in our approach will add richness to our model by combining the complementary features that emerge across natural and social science perspectives.

Discussion of Future Research and Policy Considerations

Following the groundwork laid in this paper, we suggest that future research should focus on testing and identification of potential improvements to the model framework. Using applicable data for Kenya's context, we advise a preliminary deployment of the model presented. We anticipate that preliminary findings will facilitate a more robust framework for a final study. Much of the data that appropriate for the context is mostly available from statistical databases of the Central Bank of Kenya, Communications Commission of Kenya, and the Kenya national Bureau of Statistics.

For policy purposes, it is important to be aware of the diverse contexts in which we can explore the subject of financial inclusion through mobile banking. Some considerations include money laundering (De Koker, 2013 and Olatunde, 2012), consumer behavior (Laukkanen et al, 2007), financial integration (Acharya and Bisin, 2005) and legal issues (Rolf and Darbellay, 2013), to name a few. One aspect that is common in each case is the flexibility demand this new form of technology application requires of policy makers. For example, in the case of M-pesa, with increasing velocity of transactions in Kenya, and the increasing assumption of banking services by mobile service providers, the monetary authorities are back to the drawing board to recalibrate rules on money supply and banking services respectively. In 2008, regulatory authorities in Kenya were tasked to conduct a risk assessment on M-pesa to determine how it fits into the existing framework (AFI, 2010). That said, we suggest close attention to policy concerns in future studies. We anticipate that empirical findings may reveal expose emerging policy issues that signal for accommodation under existing regimes. We can accept that technology changes are here to stay, along with the attendant cycles of creative disruptions.

Limitations of the Study

A primary limitation of this study is a lack of testing of the model framework. The collection of data for a preliminary analysis in a timely manner suffered some logistical setbacks that may require more time and effort to overcome. In addition, the depth literature of available for the context of Kenya is either difficult to obtain or scarce. The fact that this is an emerging front in Kenya's financial economy may partially explain such scarcity. In this case, similar studies in the distant future may afford a wealth of literature to draw from.

APPENDIX

1. In its modern form, the quantity theory builds upon the following relationship

$$\mathrm{M} \times \mathrm{V} = \sum(p\mathrm{i} = q\mathrm{i}) = \mathrm{p}t\mathrm{q}$$

Where,
M= the total amount of money in circulation during the period
V = transactions velocity of money
pi and qi = the price and quantity of the i-th transaction.
p = column vector of the pi, and the t is a superscript representing the transpose operator.
q = column vector of the qi.

The equation of exchange is a simplified variation accepted in economics.

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DEVELOPING CORPORATE CULTURE IN A TRAINING DEPARTMENT: A QUALITATIVE CASE STUDY OF INTERNAL AND OUTSOURCED STAFF

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ABSTRACT

This qualitative case study was conducted to investigate and analyze the perceptions and lived experiences of 20 training department staff at a New York-based early childhood multi-service healthcare company. The study was used to discover the leadership practices involved in creating a positive corporate culture in a work environment with outsourced and internal employees working concurrently together. There were six emergent themes that resulted from the study. It was discovered in the study that leaders who do the following activities continually engage the employees, whether they are internal or outsourced: (1) lead to the specific needs of each staff, whether internal or external, (2) create an environment of "fun", (3) create an environment that purports familial ties with all team members, (4) ensure that learning exists continually, (5) honor the employees who have worked in the industry the longest, and most importantly, (6) lead as a socially and emotionally intelligent leader.

JEL: L2, M1

KEYWORDS: Outsourcing, Training, Internal Employees, Outsourced Employees

INTRODUCTION

The challenge of leadership in an organization with an outsourcing arrangement continues to be more complex with the introduction of new technologies into the outsourcing solutions (Goolsby, 2010), as well as the increase in multi-cultural and multi-generational employees and contractors into the workplace (McCray, 2008). There are organizations that are able to navigate the complex outsourced-internal employee environments with success. In 2011, a Chief Financial Officer of the Year award was given to a New York-based early childhood multi-service healthcare company (Long Island Business News, 2011).

The acceptance speech of the Chief Financial Officer (CFO) became the impetus to the current study since the CFO indicated a correlation between leader's impact on corporate culture in an environment with outsourced and internal employees resulting in positive employee satisfaction and profitability of the company (G. Vellios, personal communication, November 22, 2011). The researchers in the current study identified the need to discover the leadership factors that can be cultivated to create a positive working environment when outsourced and internal employees co-exist. With the sensitive information and confidential files surrounding children's services, the organization will be anonymously identified in the study.

The purpose of this qualitative case study was to identify the leadership culture of a multi-service New York-based early childhood healthcare provider. Leadership practices influencing the corporate culture of a training department with an outsourcing-internal employee arrangement was uncovered in the study. The experiences of 20 training department staff were explored and analyzed through a convenience sample. The study can be used to examine: (a) leadership decision making, (b) management practices in relation to the workplace, and (c) the training department's corporate culture.

The remainder of the paper is organized as follows. The next section describes the relevant literature on outsourcing. Next, we will discuss the data and methodology used in the study. The results are presented in the following section. The paper closes with some concluding comments.

LITERATURE REVIEW

The literature in the study covered four topics: (a) development of training from traditional learning into corporate universities, (b) evolution of outsourcing and its link to training, (c) leadership and a leader's role in a training environment, and (d) corporate culture.

The focus of the current research was to discover linkages between the experiences and insights of a training staff and their leaders to determine how a positive corporate culture exists in a working environment with both outsourced and internal employees working concurrently. The majority of literatures utilized for the purposes of this research were published between 2007 to 2012. Title searches included words and phrases to acquire the most comprehensive sources available on the subject of outsourced training. The key terms used were *outsourcing, leadership, corporate culture, trainer, job satisfaction, performance, corporate belief systems, corporate tribal knowledge, training departments, training as business, leadership styles, management, training, learning, learning and development, training operations, training relationship management, learning consultants,* and *outsource-insource*. Numerous sources resulted from the search including scholarly and peer-reviewed journal articles, general textbooks, book chapters, and non-scholarly articles. More than 296 literature resources and 131 relevant references resulted from the title search.

While the field of training was evolving, the outsourcing industry emerged. The foundation for outsourcing can be traced to the Roman era where tax collection was systematic through contracting services (Jacques, 2006). The industrial revolution between the 18th and 19th centuries set the stage for the development of outsourcing. An increase in the production of goods accounted for externally-sourced tasks to be fulfilled. England contracted private companies for the operation of public street lights and highways, waste and prison management. France outsourced the development, management, and distribution of water storage and railways (Commonwealth of Australia, 1997).

In the United States, it was not until the mid-1960s that computer service bureaus began providing outsourced support in the financial and operational departments of organizations (Aalders, 2002). The introduction of increased production of consumer technology created horizontal or cross-function enterprise-wide relationships between host organizations and outsourced companies (Kakabadse & Kakabadse, 2002). From an agency theory perspective, the governance of work given by the host company to the outsourced company becomes the basis for the outsourcing agreement (Eisenhardt, 1989). By the 1970s, vertical or single department function outsourcing arrangements were made as organizations identified the shift from horizontal to vertical outsourcing as more efficient for the host company (Jacques, 2006).

In the 1980s, market competitiveness increased dramatically, and companies identified organizational core competencies and critical resources to ensure strategic advantages and competitive pricing with reduced costs resulting in increased outsourcing of departmental functions (DeRose, 1999). The streamlining of organizational focus provided a perspective that anything that was not considered core competency or critical to an organization's strategic vision was to be outsourced (Gefen, 2010). The precipitous drop in information and communication technology costs enabled massive investment opportunities in international bandwidth and paved the removal of communication barriers across continents and enticed companies to outsource functions *offshore* (Bhagwati & Blinder, 2009).

In 2001, the turning point was with the landmark contract between Nortel and PriceWaterhouseCoopers (PwC), where a high-end solutions provider received major attention from corporate executives to outsource training - a pivotal moment that showcased training outsourcing as a strategic component of business planning (Rosenthal, 2010). Companies like Accenture Learning contracted with Avaya University, Sun Microsystems, and General Electric's Consumer Finance; and global consulting firms like Raytheon, IBM, Knowledge Planet, Productivity Point, Convergys Exult, and Intrepid and became forerunners and further expanded training outsourcing services to include training administration operations managing all of the staff, facilities, resources, and processes of clients (Trolley, 2004).

Outsourcing expanded worldwide. Macrae (2002) forecasted"global outsourcing growth to be 20% per annum within the Pacific Rim outsourcing market alone" (p.45). Robertson (2001) estimated the market for outsourcing in Australia was A$1.3B in 1997 and jumped to A$6.4B by 2008 (Lui, 2009). Businesses in the shrinking global market experienced dramatic shifts in organizational structure and in the makeup of the employee workforce (Nilson, 2003).

Outsourcing does not automatically mean offshoring, but offshoring can be part of an outsourcing contract (Gefen, 2010). Offshoring is a "geographical relocation of a job to another nation under the aegis of the same company's foreign subsidiary or to a foreign contract provider" (Contractor, Kumar, Kundu, & Pedersen, 2011). In 1989, outsourcing officially became part of a business strategy and additional activities were outsourced, including accounting, human resources, data processing, security and maintenance (Mullin, 1996). By the 1990s, many factors contributed to the refinement of outsourcing contracts. Examples of these factors are (a) the aging population in North American and Europe creating a shortage of skilled technical and managerial personnel (Dobbs, Lund, Roxburgh, Manyika, Kim, Schreiner, & Piotrowski, 2010), (b) technological change has accelerated dramatically resulting in organizations unable to keep up with the pace of their competition (Tan, 2012), modularized tasks and activities (Sanchez & Mahoney, 1996), and (c) the increase of knowledge repositories in organizations enabled tacit expertise to be codified in process templates, training materials, software, and expert systems (Balconi, Pozzali, & Viale, 2007).

Outsourcing is a management tool that continues to be employed for a variety of reasons like financial, political, people, and product capability enhancement (Greaver, 1999). It is important that leaders understand the impact of a decision to restructure a company when the organization has outsourced and internal employees working concurrently (Contractor et al., 2011). Leadership is a key enabler in affecting the corporate culture (Aitken & Higgs, 2010). Research shows that employees continue to be dissatisfied with an outsourcing arrangement (Rifkin, 1995; Gefen, 2010) and the discontent impacts performance (Morgan, n.d.; Trolley, 2004; Klaas, Gainey, McClendon & Yang, 2005; Gainey & Klaas, 2005; Gareau & Lucia, 2010).

Satisfied and committed employees are "fully engaged and exhibit high levels of discretionary effort in support of the mission and vision of the organization" (Marciano, 2010, p. 40). Leaders are critical players in creating an environment of positive corporate culture in their role as mentor, trainer, or coach (Hamel, 2012). Motivation, engagement, and ultimate satisfaction of employees are crucial for organizational survival in the current global dynamic environment of high competition (Marciano, 2010). The current qualitative research case study explored the impact of leadership to a corporate culture of a training department staff where an outsourcing arrangement was implemented.

Outsourcing is a common phenomenon (Wankel & DeFillippi, 2008), which comes with many challenges, risks, and client complaints (Preimesberger, 2007). Concerns include hidden costs, unexpected outcomes, diminishing service levels (Lundby & Jolton, 2010), trust (Poitras, 2009), geographical and cultural disruptions (Farrel, 2006), and leadership cultures resulting in unintended low performance results (McCray, 2008). The complexity of leading a workplace with both internal and outsourced employees working concurrently continues to affect achievement of business goals (Contractor et al., 2011).

The trend of outsourcing job functions started with using external vendors to run company information systems (DeRose, 1999). Manufacturing and logistics departments were the next organizational function outsourced followed by human resources (HR) and training activities (Tipton & Nozaki, 2012). The role of the leader is crucial in creating a positive corporate culture when the working environment has both outsourced and internal employees (Stoddard & Wyckoff, 2009; Silzer & Dowell, 2010). The leader's role becomes especially important when the outsourcing contract includes outsourced individuals from different countries with dissimilar experiences and professional credentials (Gurung & Prater, 2006; Oza & Hall, 2006; Metiu, 2006).

Leadership's impact in the corporate culture of training departments with an outsource-internal arrangement has been overlooked so far. There has been a shift from training department employees having shared team identities to employees challenging workplace roles due to an increase in engagement of outsource employees (Mortensen & Hinds, 2001; Hinds & Mortensen, 2005). Employees have also challenged organizational controls (Kosmala & Herrbach, 2006) and sense-making due to the organizational changes stemming from outsourcing arrangements (Elsbach, 2003). Instances of inconsistent instructor performance (Bowersox, Closs & Cooper, 2002) and diminished learner satisfaction have been attributed to the training department outsourcing contracts (Worthington, 2002).

METHODOLOGY

A qualitative case study approach was appropriate in this research because the method allowed for the ability to identify specific data concepts for coding and determining categories and thematic patterns (Creswell, 2009). Leadership decision making is a defining aspect of leadership (Nohria & Rakesh, 2010) and the decisions made that translated into insights on corporate culture were explored and analyzed in the research. The research study used the following overarching research question: What role does leadership have on the corporate culture of a training department, with internal and outsourced staff?

A pilot interview was conducted as a trial run in preparation for the in-depth interview (Polit, Beck, & Hungler, 2001). The in-depth interviews provided an understanding of the factors that affect corporate culture. Interviewing both internal and outsourced employees yielded an understanding of the leadership factors impacting the corporate culture. Coding each interview identified trends in insights of the corporate culture. Interviews were analyzed through pattern recognition software, e.g. NVivo10®, of specific key words that were indicative of the subject's trait or behavior.

The current research investigated the occurrence of leadership influence on the working environment of a New York-based early childhood multi-service healthcare provider's training department with an outsourcing arrangement. The research was conducted at a New York-based early childhood multi-service healthcare training department. The researcher documented the in-depth interviews using a web-based communication device called Skype™. There were 20 training department employees, in various roles including outsourced employees, interviewed in the study.

The goal of the research study was to understand the factors of leadership practice's motivational drivers towards a positive working environment with an outsourcing arrangement. This qualitative research case study used the following research question: What is the role of leadership in developing a corporate culture where internal and outsourced employees work concurrently in the same training department environment? The sub-questions to the research question were: What is role of the leader to the employee's perception of the work environment? What is the role of the leader to an internal employee's perception of outsourced coworkers as it relates to the corporate culture of the work environment? What is the role of the leader to an outsourced employee's perception of internal coworkers as it relates to the corporate culture of the work environment?

To discover the reasoning behind the positive corporate culture of the researched organization, in-depth interviews focused on deliberated questions that directed study participants to the importance of the research study's design based on observation, insight, and knowledge (Moustakas, 1994). A highly rich description, particularly of novel or unique experiences, of the study participants enabled the researchers a deeper understanding of the corporate culture (Swanson & Holton, 2005). There were seven assumptions made in the research process.

First, it was assumed there is a possibility of gaining an insight about the culture of the organization in the study. Data was collected from the leadership phenomenon of a training department with an outsourcing agreement. The purpose of the research study was to uncover the experiences of the identified staff to explore the reasons behind the positive corporate culture in the workplace. In attempting to uncover the underlying essences and meaning of lived experiences of the study participants to arrive at a deeper, inter-subjective understanding of the phenomenon (Gibson & Hanes, 2003), the second assumption was that study participants identified the existence of a positive corporate culture in the company studied.

A third assumption was that study participants were willing to participate in the study and responded honestly to the interview questions. The employees have all been part of the shift from a pure internal employee only organization to an outsourced and internal employee structure. The fourth assumption was that study participants were able to recall the experiences they had from the shift of internal employee only organization to an outsourced and internal employee structure.

Due to research into the intensity and sensitivity of job satisfaction, as well as employee motivation, the fifth assumption was that the research study topic would not bias the responses of study participants to potentially impact the results of the research data. The sixth assumption was that the qualitative case study research method was the suitable method to use within the circumstances of the research. The last assumption was that the results of the research study would contribute to the field of knowledge.

A key component of research is to identify the most appropriate participant for the qualitative research study. Any potential participant falling within a high risk classification (i.e., pregnant women, children under the age of 18 years, residents of prisons or institutions, the elderly, terminally ill, comatose, cancer patients, individuals with AIDS, and mentally incompetent individuals) were not included in the current research study. Since the current qualitative study methodology is intended to deepen understanding more than to predict, participant selection were based on individuals who became the catalysts for dialogue about their lived experiences (Jemielniak & Kociatkiewicz, 2009). The criteria for the current research study's population were the individual was (a) an internal or contract employee, (b) employed by a New York-based early childhood multi-service healthcare provider, (c) a member of the training department staff, (d) currently working in an environment with internal and outsourced contract employees working concurrently, and (e) be at least 18 years of age.

In order to fulfill the research study criteria, participants were selected by the researcher through purposeful sampling due to availability and willingness (Patton, 2002). There were 10 outsourced and 10 internal employees who participated in the study. Of the 20 members of the training department staff, eight had direct reports, and the rest of the participants were outsourced instructional designers, outsourced instructors, internal trainers, and training coordinators. The sample excluded employees of the organization who were not part of the training department.

The current study participant invitation included a copy of the informed consent form. The contents of the informed consent form included (a) the researcher's name, university affiliation, and mailing address; (b) the current study's purpose; (c) the study participant's eligibility criteria; (d) the risks and benefits of the study; and (e) the details of a contact for any additional information requested (Creswell, 2009). While at the consent stage, the participants were encouraged to reflect on the elements of the current study, and to participate voluntarily in the research (Miller & Boulton, 2007). Each study participant was asked for an e-mail address or a fax number for purposes of presenting the informed consent form for their review and reference.

The research study invitation informed prospective participants that the study involved an in-depth web-based interview that lasted approximately 30 to 60 minutes. The informed consent form included a notification of voluntary participation in the study and provided the option of withdrawal at any time without consequences to the subject's current or future employment status. The informed consent form also indicated that study participants were not compensated, nor was there any risk associated with their participation.

Web-based interviews were recorded for accuracy and were part of the informed consent form. The study participants were informed that an audio-recording of the interview was to be made. There were an additional hand-recording and transcription by an external company of the audio-recordings to triangulate the data (Flick, 2002). In the event a participant refused to be audio-recorded, the researcher hand-recorded the interview. Participants were advised that interview questions were conducted for the purpose of research only and would be provided with a published summary without any reference to the participant's personal information.

The results of the research were triangulated by documentation on employee performance reviews of the study participants. The documentation and descriptive narrative from the interviews provided the support necessary to strengthen the validity and reliability of the qualitative research (Yin, 2009). A copy of the transcribed in-depth interview was sent by e-mail to each of the respondents to review for accuracy. Every respondent was instructed to make any necessary transcription changes and send the updated transcription to the researchers by e-mail. A deadline to return the updated transcription was given to all participants. Each participant was thanked for their participation to the current study. Updates given by the participants included spelling and grammar corrections or deletion of text. Any inaudible text provided by the transcription service was corrected by the researcher and then changes were confirmed by the study participant for accuracy.

The prospective participant was advised the research data will be secured in an offsite locked storage facility for the sole purpose of keeping the data private, confidential, and secure. Participants were informed that 3 years after the interview, any and all paper documents, audio and web-based camera recordings, as well as flash drives, will be discarded and destroyed. All paper documents and audio recordings will be frayed and shredded. A document shredding service will crush and discard web-based camera recordings embedded on flash drives.

RESULTS AND DISCUSSION

The in-depth interviews were conducted by a web-based communication device called Skype™ while the study participants were at a team bi-annual gathering at the organization's main office in New York. Each study participant was asked to go to a private room specifically setup with a laptop, a webcam, and Internet access for the interview. No other individual was in the room. Upon completion of the interview of one study participant, the participant would leave the room, and another study participant would come in to be interviewed.

The resulting 20 in-depth interviews were transcribed by a third party. The third party signed a confidentiality agreement to ensure the anonymity and security of the study participants and their responses. To ensure anonymity, an identification code was given to each study participant starting with 6 to 26. The letters SP (study participant) were used to identify each participant to assist in determining participant responses in place of using the actual name of the participant.

The population of the current case study included eight management level staff with roles like a project manager, manager, director, and vice president and 12 department staff with roles like administrative assistant, training coordinator, instructional designer, facilitator, developer, and learning consultant. The criteria for the current research study's population was (a) internal or contract employee, (b) employed by the current study organization, (c) a member of the training department staff, (d) currently working in an environment with internal and outsourced contract employees working concurrently, and (e) be at least 18 years of age.

There was equal representation between internal employees and outsourced employees from all the participants interviewed. Of the 20 participants, 10 participants were current outsourced employees who held positions such as project management, trainers, instructional designers, learning consultants, developers, managers, and coordinator. The 10 internal employee study participants held similar roles including senior manager, director, and vice president.

There were five participants who have been in their current position between 7-10 years, nine participants between 4-6 years, and six participants have been in their role for 1-3 years. The outsourced employees have a total of 47 years among the 10 study participants and the internal employees have a total of 49 years. The 20 participants have a total of 96 years in the current position and a total of 186 years in the industry. The study demographics included participant time in the organization as well as the training industry. The demographics also incorporated questions on gender, ethnicity, and age. Each study participant was also asked to provide their academic background (see Table 1).

The purpose of the current qualitative research case study was to uncover opportunities for leaders to create an environment of positive corporate culture in an organizational structure with internal and outsourced employees. Six emergent themes resulted in the current study. First, the employee's expectation and experience was linked by a leader's ability to understand each employee's needs. Leaders need to be socially and emotionally intelligent at the core of their behaviour to develop and permeate a positive working environment. Second, it is imperative for a leader to engender a sense of belonging to a family in the corporate culture. Third, leaders need to have the capability to modify their leadership approach depending on individuals who are in their employment. Fourth, respondents with the highest adaptability rate are those who have been in the industry the longest. Fifth, it is important for leaders to create a work environment that is fun for all team members. Sixth, continuous learning is imperative to engage continually with the employees (see Figure1).

Table 1: Current Study Demographics

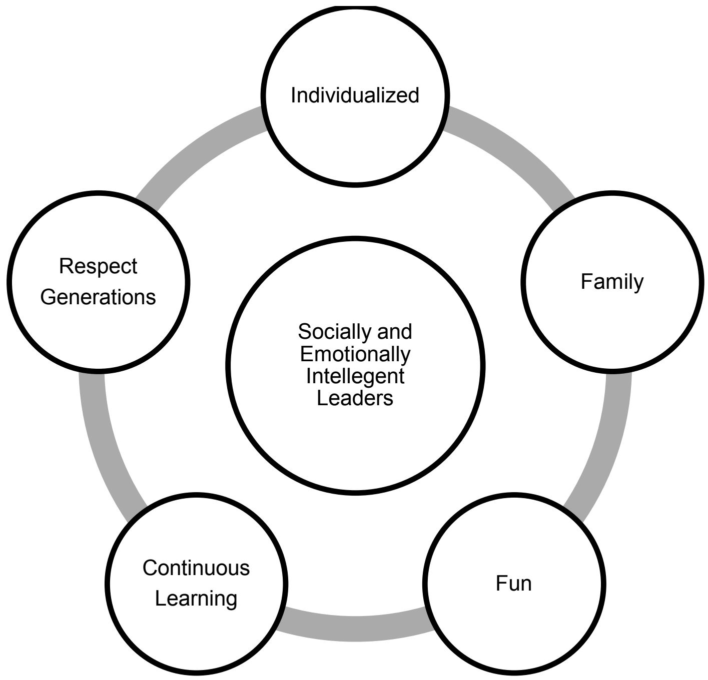
		Gender		Ethnicity				
Total Time in Org. (years)	**Total Time in Industry (years)**	**Male**	**Female**	**African American**	**Asia American**	**Caucasian**	**Hispanic American**	**Native American**
96	186	60%	40%	20%	13%	35%	25%	5%

Age			Education			
26-35	**36-45**	**46+**	**Associate**	**Bachelor**	**Master**	**Doctorate**
50%	35%	15%	5%	30%	60%	15

This table shows the demographic information provided by both outsourced and internal employees in this study.

The research revealed a work environment that links leadership approaches to developing a positive corporate culture. It was discovered in the study that leaders who do the following activities continually engage the employees, whether they are internal or outsourced: (1) lead to the specific needs of each staff, whether internal or external, (2) create an environment of "fun", (3) create an environment that purports familial ties with all team members, (4) ensure that learning exists continually, (5) honor the employees who have worked in the industry the longest, and most importantly, (6) lead as a socially and emotionally intelligent leader.

Figure 1: Emergent Themes from Current Research Study



This figure shows how five emergent themes are linked to the main theme of having a need to have socially and emotionally intelligent leaders.

The implication for organizational theorists is the importance of trust, openness, and the need for employees to articulate their specific needs to their leaders to impact the corporate culture positively. It is imperative for the leader to listen actively to the specific needs of each team member, modify the leadership approach to address those specific needs, and have a heightened social and emotional intelligence. The data from the current study interviews discloses the linkage between leadership approaches to work environment.

The challenge in the current economic landscape is the overwhelming occurrence of financial issues, which result in rewarding training manager's performance for fiscal reasons alone (Chartered Institute of Personnel and Development, 2012). Training department leaders need a holistic balance between financial status, employee satisfaction, and organizational performance. The current study shows how a leader's approach impacts internal and external employee satisfaction. The leader also acts as a catalyst in fostering a positive corporate culture. Garmendia (2004) indicated that a positive corporate culture is correlated positively to organizational performance.

The literature is rich in the areas of training, outsourcing, leadership, and employee motivation as separate fields of studies. Corporate training departments' mission statements align with corporate vision and goals (Meister, 1998). With the growing operational costs of training, outsourcing became an option to continue supporting business requirements within the shrinking budgetary constraints of training departments (Contractor et al., 2011). Leaders became more focused on running training departments like a business (Mumma, Todd, & Trolley, 2011) with the human side as a secondary lever (Brinkenhoff & Gill, 1994). Kehres (2011) indicated that companies with outsourcing arrangements could have a negative impact on their employees. Such an agreement can lead to disharmony, dissatisfaction, and low productivity in the workplace (Kehres).

The literature on motivation in corporate environments, though in-depth, is not fully researched in the area of training and development staff motivation in a workplace of internal and external employees working concurrently. Studies show that high performing work units benefit companies through increased productivity and service quality, advanced levels of safety performance, and financial stability (Gareau & Lucia, 2010; Marciano, 2010). Employees' level of trust and sense of ownership are the results of high performing work systems (Appelbaum, Bailey, Berg, & Kalleberg, 2000; Zacharatos, Hershcovis, Turner, & Barling, 2007). The impact of the current study relates to the linkage between the training department leader's approach and employee satisfaction and motivation, whether internal or outsourced.

CONCLUDING COMMENTS

Karim (2008) indicated a strong correlation between emotionally intelligent leaders and the overall employee commitment to the organization; a commitment that includes employee satisfaction and motivation. The current study is significant to leadership as it reflects the linkage between socially and emotionally intelligent leaders and highly satisfied employees, whether internal or outsourced.

Gefen (2010) indicated that in outsourcing arrangements, the external employees are part of the fabric of the host organization, and management should not differentiate the corporate culture accorded to outsourced and internal employees as the relationship has become a true, shared venture. The current study confirms the leadership approach to external employees, in relation to developing familial ties, does not differ from treatment received by internal employees. The current research differentiated relationship building with employee development. The caveat is for contractors to remain independent of the host company as it relates to personal development. The legalities of developing an outsourced employee can be viewed by leaders as a limitation to the complete engagement of all employees.

As a result, the leadership approach could be individualized in addressing specific employee needs and requirements whether internal or external. Second, leaders could create a fun environment. Third, it may be important for leaders to develop an environment that purports familial ties with all team members, whether they are internal or external. Fourth, it could be a key factor for leaders to create an on-demand training environment. Fifth, it may be imperative for leaders to encourage and support the participation of team members, who have been in the industry the longest as they have the greatest capacity to adapt when the right work environment is in place. Sixth, it may be important for leaders to be socially and emotionally intelligent in their leadership approach. The basis of the recommendations stems from the themes from the current study linked to the responsibility of the training department staff, management, and organization.

Leaders have an impact to the corporate culture of an organization (Kaplan, 2011). The themes that emerged from the current study reflect the following recommendations to training department leaders with an outsourced and internal employee arrangement:

When planning for an outsourcing engagement, it may be imperative for leaders to consider the impact to the employees and to create a strategic people plan. The people plan should include both internal and external employees. It may be important to identify the workplace environment after the outsourcing arrangement is implemented by conducting an impact analysis on individuals' needs, behaviors and attitudes.

Workplace fun may require planning from leaders. Fun goes beyond the existence of humor and play. Leaders may need to create an environment that engenders an emotional connection among the team members to allow them to feel that they are part of a family.

Adaptability is not generational but individualized. There may be a need for leaders to create an environment where learning is addressed individually to the needs of each employee. Have different learning inputs: face-to-face, online, social networks like learning labs and communities of practice. This approach will address the needs of a multigenerational workplace.

It may be important to incorporate social and emotional intelligence training not just for leaders but for everyone in the organization. This will assist in providing an environment of heightened respect, authenticity, and strengthen relationships amongst team members.

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US POST COLD WAR GRAND STRATEGY AND MULTILATERAL NATIONAL INTEGRATION IN EUROPE AND EAST ASIA

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ABSTRACT

East Asian liberal intergovernmental integration is unlikely to occur without formal engagement by the United States. An Asian Union is therefore improbable. The European Union model is not transferrable to East Asia in that the former is a multilateral organization that has emerged that can claim authoritatively to speak for Europe. The Cold War context for European liberal intergovernmental integration included US policies constituting the strategy of containment towards the USSR. US incentives to coordinate west European policies towards the Communist bloc targeted mid-range power allies. These European nation states were roughly equal in their national power capabilities. The USSR did not have the hard or soft power capabilities to claim irrefutable membership in the same European club. Even traditional Russian allies such as Bulgaria have sought affirmation of their European identity through accession to the EU. A similar US-led containment strategy towards China is unlikely. Creation of a multistate Asian regional organization that will persuasively claim to represent Asia in opposition to China is unfeasible. Potential power disparities among East Asia states will be so significant that China cannot be a pole of opposition against which to construct Asia. Pan-regional integration should be Pacific-oriented rather than Asia-focused.

JEL: F5

KEYWORDS: Bulgaria, China, East Asia, European Union, Grand Strategy, Liberal Intergovernmentalism, Nationalism, Russia, Soft Power, Trans Pacific Partnership

INTRODUCTION

In Fall 2009, the international media reported Asian agreements to pursue general initiatives for an East Asian-region integration movement with the European Union as its model ("Asian EU," 2009). These reports highlighted the new Japanese Prime Minister, Yukio Hatoyama, as the resuscitator of this proposal (Mulgan, 2009). Disagreements emerged over the envisioned role of the US in Asian integration while China, Japan and South Korea were portrayed to be core prospective members (Brown et al., 2009). While debating which state leadership first made such a proposal, various media commentaries viewed the ASEAN states as candidate members of such an envisioned community (e.g. Xu, 2009). The Hatoyama government fell in June 2010, and Japan then saw a series of short-lived governments that did not follow up on the Asian Union proposal. Meanwhile, in November 2009, US President Barak Obama announced his administration's support for the Trans Pacific Partnership (Luce et al., 2009). The US joined the TPP negotiations in March 2008, transforming what initially had been a trade pact between Brunei, New Zealand, Chile and Singapore (Trans-Pacific Partnership, 2013). It is now a prospective agreement that also includes Australia, Canada, Malaysia, Mexico, Peru, Vietnam and Japan. Japan's formal accession to the negotiations in July 2013 under Shinzo Abe surprised some observers (Pilling et al., 2013). The formally named Trans-Pacific Strategic Economic Partnership Agreement raises the question as to the nature and direction of East Asian integration.

A recognizable Asian parallel to the European Union is unlikely. US power and commitment have been critical independent variables shaping the EU's integration. They will also be critical in shaping East Asian integration, but more so. China's comparatively much greater hard and soft power capabilities relative to its neighbors mean that the US must be a formal leader of Asian integration strategies. China's relative capabilities mean that China cannot be excluded from Asian integration, like the USSR was formally excluded from European integration during the Cold War. On the other hand, these same capabilities require US soft and hard power engagement of China to allow for the potential of Pacific regional integration on the basis of liberal intergovernmental approaches (Buse, 2012: 53). US-led strategic containment of the USSR was a critical factor shaping the environment of European integration. US strategic engagement of China will be necessary if not sufficient for Asian integration, meaning that Asian regional integration must be part of a broader Pacific integration orientation.

This study contributes to the development of the concept of grand strategy within the international relations literature. It presents a comparative analysis of international and state-level trends shaping postwar regional development in two geographic areas. It highlights analytical development of the role of soft power in multilateral integration in relation to regional nationalisms as part of US grand strategy in these two area cases: Europe and East Asia. A theme in this literature is that the US has been pursuing a grand strategy that emphasizes promotion of liberalism since 1945 (Green, 2012: 10, 23-26; Freedman, 2006: 63; Forsythe, 2002: 505-10). The strategy has been characterized as structuring other regimes and their international environment to promote the "democratic peace" among these democratic states (P. Miller, 2012: 49, 63). P. Miller notes that this strategy has not been explicitly adopted by US foreign policy decision makers; rather it is an overall pattern that is inferred by the analyst (2012, 49-50). In this vein, a purpose of this study is to explicate the respective European and East Asian regional implications of long term US foreign policy today, with its roots in the Cold War. As a soft power amenability factor, the authoritative legitimacy of the claim of popular sovereignty via national self-determination has become internalized globally among state elites (Buzan, 2010: 25).

A liberal hegemonic power is more likely to promote self-determination with a soft power emphasis in a multilateral framework when engaged in a defensive strategy against a Great Power challenge (B. Miller, 2012: 33). Different constituencies within a polity, liberal or otherwise, will compete to promote different strategic approaches (B. Miller, 2012: 35, 57-59, 61-62; Tsygankov, 2011: 30-31). They will vary in their defensive versus offensive orientation in their respective advocacy of power application. Concomitantly, these constituencies will support with varying degrees of intensity the international promotion of the liberal hegemon's political regime ideology. Their advocacy will vary along a continuum between defensive, cautious, multilateral "exemplarism" and offensive, crusading, unilateral "vindicationism." Their variation along this continuum will reflect the intensity of the perceived challenge these constituencies see to the liberal hegemon as well as their respective functional organizational roles in the polity (B. Miller, 2012: 33-34). A conceptualization of nationalism for a focus on its critical role in determining the efficacy of soft power application in grand strategy is necessary. This study utilizes the theoretical framework for nationalism developed by Martha L. and Richard W. Cottam that applies findings from social psychology (2001). National self-determination is a manifestation of a national group's collective motivation for national in-group self-assertion in the world community. Nationalism manifests different patterns of collective perception of self and other in different political contexts with consequent derivative systematic policy behavioral patterns. Satisfying this national self-determination need is critical for effective soft power capability in great power grand strategy.

This comparative analysis first begins with an explication of the relevance of nationalism to the substance of soft power during the Cold War and its implications for the Trans Pacific Partnership. Earlier, the US had success in generating pro-US political trends in European perceptions and attitudes through US support for European integration. This US support occurred within the context of the US containment strategy towards the USSR and its Warsaw Pact satellites perceived as threatening European national self-determination. Yet US Cold War strategic policy tended to assume that radical Third World nationalist movements were more vulnerable to Soviet subordination, resulting at times in disastrous outcomes as in Southeast Asia. The second section focuses more closely on the European Union's institutional accommodations to European national self-determination aspirations. It includes an analysis of traditionally pro-Russian Bulgaria as a case study. The third section critiques the applicability of the lessons drawn from the successes of European integration to a prospective East Asian integration project. It focuses on the challenge of China's preponderant regional hard and soft power potential capability following a modern history of self-perceived national humiliation by external and regional actors. The fourth section illustrates the inappropriateness of a reformulation and application of the US Cold War containment strategy in Europe towards China. Such a strategy is less likely to promote East Asian integration as a political byproduct as it did in Europe. Yet, due to regional power disparities, US leadership will be necessary, if not sufficient, to permit the potential for peaceful regional integration. This integration should be expanded to the Pacific to include formally the US rather than limited to East Asia. The fifth section underlines that the political roots of US policy towards Asia lie in the Cold War.

The US containment strategy towards the USSR supported opportunities for China to become a de facto US ally in the 1970s. The resultant integration of China into the global capitalist production chain generated interdependencies hindering the emergence of a new US containment strategy in response to China's post Cold War rise. Asian regional nationalist resentments lingering from the age of Western and Japanese imperialism that were subdued during the Cold War have reemerged. They also complicate prospective efforts to establish multilateral regional security frameworks supportive of economic and political integration. The sixth section critiques the strategic policy inclinations of the US G.W. Bush and Obama administrations in terms of their respective assumptions regarding Chinese foreign policy motivation. It highlights the danger of a China-US conflict spiral due to mutual suspicion regarding each other's ultimate regional objectives and draws consequent policy recommendations. While suspicion prevails in Beijing regarding US willingness to recognize China's global national dignity equality status, the intensification of national grandeur as a motivation is a possibility. The last section concludes that opportunities are greater for US accommodation of China's rise within a Pacific regional framework than they have been towards post Soviet Russia in Europe. The founding, deepening and widening of post 1945 European integration continues to exploit the political opportunities that the US containment strategy towards the USSR generated. A greater potential exists for promotion of post Cold War Pacific integration under US leadership with less functional emphasis on responding to a perceived challenge from a common enemy. Of course, state leaders particularly in the US must have the acumen to exploit these opportunities while avoiding the potential conflict spiral pitfalls.

Nationalism and Integration

Regional integration institutions confront state foreign policy unilateralism (Beeson et al., 2010). The prevailing, but not the sole, view in Washington, DC is that US-led containment successfully countered a militantly imperialist Soviet Union. Containment's primary assumption was that the USSR was in effect a Russian version of Nazi Germany (Bush, 2001). Consequently, American-led European multilateral regional institutions today are seen in Washington and Europe as instruments for peace and prosperity. In Europe, the US was generally allied with respective national self-determination impetuses opposed to Soviet domination during the Cold War. In the Middle East, Africa, Latin America and Asia, however, US containment strategy during the Cold War often placed the US in opposition to nationalist movements. The US defeat in Vietnam was due to the US opposition to pan-Vietnamese nationalism. In the Middle East, the US has opposed pan-Arabism and pan-Islamist movements but allied with Zionism during and after the Cold War. Much discussion has circulated in the last decade about the relevance of soft power and US advantages in this regard (Nye, 2007). The use of soft power is an appeal to public opinion, and public opinion cannot be understood in the modern era without an understanding of nationalism. To the extent that the US is perceived as allied with target public national self-determination aspirations, then it will have a soft power advantage. To the extent that it is seen as hostile to national self-determination, then it will lose soft power effectiveness in its policies. The US promotion of the

Trans Pacific Partnership trade liberalization initiative with itself as the lead power within it may be critiqued in these terms (Office of the United States Trade Representative, 2012).

Regional integration efforts have to accommodate national self-determination demands. As the US is playing a leading role in these regional integration initiatives, it uses them to pursue its foreign policy objectives. The EU is a model for regional integration proposals such as the African Union and the proposed Asian Union (Xu, 2009). Firstly, an appropriate conceptualization of the nature of the relationship of the US to EU integration during and after the Cold War is necessary. Secondly, the relationship of the US to China is another critical focus. Asian integration efforts confront a China in which much suspicion exists that the US and its allies see China as an upstart threat and see the TPP in this context (*Global Times*, 2013). Washington's perception of challenge from China is not now as intense as it was regarding the USSR. The US is likely to have soft power advantages that it can institutionalize through supporting Pacific integration, as it did in Europe. The US, however, will be unable to copy the European model of integration to an East Asian model. China's power capabilities prevent the construction of an Asian political community in a manner parallel to the construction of a European community heretofore excluding Moscow. Chinese capabilities include its own soft power appeal as the historical political center of Asian Confucian civilization (Kang, 2010). The US therefore supports a broader Pacific regional integration approach that includes it in the form of the Trans Pacific Partnership.

European Nations and European Integration

One popular introductory textbook on the European Union labels liberal intergovernmentalism as the predominant theoretical framework for conceptualizing European integration (Dinan, 2012: 24). An explanation for the mutual cooperation of nation states within a liberal framework requires an appropriate theory of nationalism to analyze it. The group political psychological approach utilized here, developed by Cottam and Cottam (2001), provides a useful conceptualization of nationalism. It explains this behavior in terms of European Union membership having a foundation in soft power appeal to mainstream nationalist public opinion among the peoples of Europe. This soft power appeal derives from European integration appearing to validate the perception that the European nations west of Russia are not under any particular national domination. This perceptual assumption prevails significantly due to success in creating persuasive EU institutional safeguards. These policy-making mechanisms prevent the coalescence of public perceptions of EU systematic biases favoring the influence of particular nation states over EU policy-making processes. It generates this powerful perception of the existence of equal national sovereignty despite obvious cultural, economic and political power potential differences among the peoples of Europe. Cottam and Cottam describe this psychological strategy for integration as promoting "social creativity" in national collective intergroup perception of self and other (2001, 266).

The nations of Europe are different while not under particular national domination, or in positive terms, they are different but equal. Today, Europe is predominantly equated with the European Union (e.g. Jacobs, 2012). The EU has so far avoided mass public perceptual equation of national cultural differences with a solid and immutable status hierarchy among its member states. The institutions of European Union policy making help support these collective perceptual psychological adaptation strategies towards national acquiescence to EU integration. They do so despite the wide range in power capabilities among the 28 EU member states (Nugent, 2010: 289-306). "[T]here are often no clear lines of authority or hierarchy between the different levels" of EU policy making (Nugent, 2010: 291). These institutions are necessary for the economic and political liberalism-based approaches for European cooperation and integration. In sum, liberal intergovernmentalism in Europe has its basis in the mainstream predominant view among the respective national publics that they differ in their relative power capabilities. Yet they are not under national domination by one or an alliance of other nations. Maintenance of this prevailing perception is necessary for European integration to develop.

The Cold War conflict from the late 1940s until the early 1990s supported this social creativity collective perceptual outlook. The Cold War conflict functionally incentivized social creativity in European national collective perception of self and other. This incentive lay in the different European nations west of Russia to different degrees perceptually sharing a common adversary in Soviet Russia. In other words, the enemy of my enemy is my friend/ally (Cottam and Cottam, 2001: 96-100). The decline and end of the Cold War generated additional challenges for liberal intergovernmentalism. EU Economic and Monetary Union builds more heavily on economic and governmental bureaucratic vested interests to continue the integration approach. Yet the shared perceived challenge from Russia continues ("How do you solve a problem like Russia?," 2013).

Bulgaria: Balkan National Identity in Transition within Euro-Atlantic Hegemony

A political psychological approach to nationalism as a motivational political value helps illuminate the meaning of creating a modern European state in post Communist Eastern Europe (Hajdinjak et al., 2012). The case presented is a former Soviet client state, Bulgaria. (Hajdinjak et al. state that "[t]he project was funded by the Seventh Framework Program of the European Commission (FP7 2007-2013) […]"). This study applies Cottam and Cottam's theory of group image stereotypes towards perceived sources of challenge to the national in-group. Behavioral predispositions and consequent political strategies associate with these stereotypes. The emotive force of individual or collective political behavior that associates with nationalism derives not primarily from the appeal of an ideology. It derives from the deep emotional commitment that individuals and groups have towards defending the positive image that they aim to maintain of their nation. Their nation is their primary, terminal self-identification in-group, which may or may not correspond with the state borders in which they find themselves placed. They tend to associate the status of the in-group with their own status. Perceived challenges regarding the comparative social status of the national in-group are more likely to be taken as perceived slights to oneself (Cottam and Cottam, 2001: 1-4). The perspective taken is that of an in-group responding to a negative social self-comparison towards an out-group, e.g. Bulgarians' collective self-image in relation to West Europe.

The in-group may choose to respond psychologically in different ways. Between actors perceived as relative power equals, "social competition" refers to direct competition between groups for status and influence. In intense, zero-sum conflict situations, one side's observed gain in influence and status is perceived as the other side's loss (Cottam and Cottam, 2001: 92-93). Political conflicts may be intrastate, as in ethnic civil war situations, as well as in the global political system, as in full-scale war (hot or cold) situations. Social creativity strategies aim to preserve a positive group self-image through creating a collective perceptual reality in which different, equally valid yardsticks for evaluation apply to different groups, i.e. different but equal. "Social mobility" strategies refer to seeking to join and assimilate into the perceived, "superior" out-group (Cottam and Cottam, 2001: 92, 267).

Euro-Atlantic integration aims at promoting integration through social mobility and social creativity in perception of self and other. Social mobility refers here to Europe as a perceived area of individual career and group opportunity and national economic development. Particularly in Eastern Europe, these possibilities emerge through willing amalgamation into the perceived, more advanced pan-European community through policies of soft power cooptation (Nye, 2007: 391). Social creativity refers here to the promotion of the perception and attitude through European Union public policy of national-ethnic groups in Europe as different but equal. The evaluation relates to their perceived comparative social status in Europe (Cottam and Cottam, 2001: 87-122). Among the traditional great power nation states of Europe having comparable power capability, Germans are classified/stereotyped to be more methodically effective. The French are classified/stereotyped for their superior logical incisiveness. The Italians are classified/stereotyped for their superior emotive communication skills, etc. All are supposedly equally appreciated and valued in the European Union contextual community (Lewis, 2006). Lewis (2006) is an example of the subfield in the strategic management literature that focuses on the weaknesses and, of course, strengths, of different national cultures. Consequently, European integration may be conceptualized as a peace strategy. In other words, it aims to eliminate conditions conducive for the occurrence of national social competition in the European region. The relative power equality among European higher power states is a keystone for this necessary approach. Pro-Euro-Atlantic Bulgarian political formations view Euro-Atlantic structures more in accordance with the "ally" perceptual ideal stereotype. The jointly-shared sources of perceived threat stem from overt and covert challengers (Cottam and Cottam, 2001: 96-98, 100). Overt challengers may be perceived excessive Russian governmental influence. Covert challengers may include perceived subversive informal political economic structures. They include informal intelligence and organized crime structures deriving from regional networks that originally developed during Communism. These domestic informal Bulgarian structures are under suspicion of continuing cooperation with international counterparts in Russia and elsewhere.

Historically, imperial powers such as Russia/Soviet Union have viewed Bulgaria more in accordance with the "colonial/client" stereotype (Cottam and Cottam, 2001: 96-98, 100, 118-21). For example, Russian President Boris Yeltsin presumed Bulgaria to have a special relationship with Russia. He described Bulgaria as a potential candidate to join a new, post-Soviet "quadrilateral community" integration agreement between Russia, Kyrgyzstan, Kazakhstan and Belarus. Dr. Zhelu Zhelev, the Bulgarian President and leader of the pro-Euro-Atlantic, Union of Democratic Forces party, as well as the post-Communist, Socialist party government under Prime Minister Zhan Videnov, formally rejected Boris Yeltsin's public invitation. While they protested against Yeltsin's presumption, demonstrations occurred in Sofia against Yeltsin's comment ("Bulgaria Will Present a Note to Russia on President Yeltsin's Statement," 1996; "Bulgarian Ambassador in Russia Delivers Verbal Note," 1996; "Southeastern Europe: Bulgarian Political Roundup," 1996). Bulgaria joined the EU on January 1, 2007 ("Bulgaria in EU: Ode to Joy," 2006).

<u>Communist Bulgaria: The Closest Ally of the USSR</u>

The Soviet authorities considered the People's Republic of Bulgaria its closest ally, seeing Bulgaria as most willing to copy Soviet policy models ("Former Friends," 2001). The totalitarian, political economic component of Soviet imperialism left a comparatively stronger ideological-attitudinal legacy in Bulgaria. This legacy also interacted with the earlier collective memory of Slavic Orthodox Russia's critical role in Slavic Orthodox Bulgarian national liberation in 1877-78 from the Ottoman empire. Bulgaria had been part of this Muslim empire for five centuries. An informal reference to Russia among Bulgarians today remains Big Brother Ivan. During 1944-89, Bulgaria as a client state of Moscow underwent a period of rapid, forced economic, social and political change under a Communist totalitarian regime. This change can be labeled modernization depending on the indicators that one may choose, but Bulgaria did rapidly change. During this same period, the People's Republic of Bulgaria acquired a reputation as the closest ally of the USSR in the Warsaw Pact, twice applying to join the USSR (Dyer, 2009; Katsikas, 2012: 5-6, 19). A prominent Russian concern is that the EU's "Eastern Partnership" program is a strategic effort to reduce Moscow's influence in the territories of the former Soviet republics (Clover, 2009; Kramer, 2013). Moscow's suspicions undoubtedly receive confirmation from certain media reports. They highlight unofficial EU leadership warnings that failure to improve Bulgaria-EU cooperation may result in a strengthening of Russian influence in Bulgaria. Bulgaria's ties to the EU are portrayed as threatened by Bulgarian governmental inefficacy in combating pervasive corruption (Barber, 2009).

Bulgaria's European integration interacts with its collective historical legacy of domination by others. Bulgaria's history has led the Bulgarian polity collectively to tend to see threats from Great Power actors historically perceived as superior both in capability and cultural level: the imperial image. Internalization through socialization of the inferior, colonial/client self-image can be the basis of modern, neo-colonial relationship with an imperial power (Cottam and Cottam, 2001: 91-92, 97, 99, 111-16, 118-20, 273-74).

In addition to 500 years of Ottoman control, the contemporary Bulgarian state itself had much of its foundations laid under the "Sultanism" of the decades long Soviet client dictatorship of Todor Zhivkov (e.g. Eke et al., 2000: esp. 531).

These stereotypes of self and other decay in the current post Communist and post colonial development phase of the Bulgarian national community. The process of decay is likely to manifest itself in social tendencies including nationalistic political self-realization movements articulating social and political justice demands (e.g. Zubok et al., 2011: esp. 33-38). These movements may be led by an alternative set of aspiring ruling elite. In sum, one should expect to see militant nationalistic behavior in post-1989 Bulgarian democratic politics. It would likely pose a challenge to the relatively peaceful relations that have been maintained between the Bulgarian Orthodox majority and the Muslim, Turkish and Roma minorities since 1989. More intense affirmation of national in-group identity increases the propensity for the members of the in-group to find social causality for their dissatisfaction by blaming out-groups for society's problems. A negative stereotype of that group may promulgate on a wide scale, i.e. scapegoating (Cottam and Cottam, 2001: 73). European Union external intervention serves to promote opportunities for social mobility and social creativity as means of conflict resolution within Bulgaria and the Balkans. This intervention is being put to the test in the midst of the radical ongoing change processes in Bulgarian societal authority norms (Tsolova, 2013).

Challenges to East Asian Liberal Intergovernmentalism

Liberal intergovernmentalism in social creativity strategies in Asia faces particular challenges that have been less prominent in Europe. The power potential base differential between China and the rest of Asia is the most important factor (Cottam et al., 1978). China's globally superlative power potential base is evident for all to see. The most powerful West European nations are roughly comparable in power capability. This awareness stems from the number of costly failures to establish hegemony over Europe by a European state at least since the 1648 Treaty of Westphalia. Moreover, unlike the predominance of comparatively homogenous nation states in Europe, a number of states in Asia are not nation states. Their populations consist of multiethnic communities within more or less arbitrarily created state territorial boundaries drawn by former European imperial powers. Nation states like China, Vietnam and Japan are not typical. The existence of nations as state political communities represented by their respective governmental apparatuses underpins European liberal intergovernmentalism. In Asia, China has 20% of the world's population, 94% of which belongs to the Han ethnic group (Levinson, 1998: viii). They tend to view themselves as members of a political community many centuries old despite great cultural diversity within the Han core group (Cottam and Cottam, 2001: 83-84). Other such cases are not typical: e.g. Japan, Vietnam, and Korea (still bifurcated). India and Pakistan are also in the multiethnic category. The assumption of relative equal power capabilities is harder to maintain cognitively and perceptually in Asia. Comparisons are made between the rise of China and the rise of Imperial Germany beginning in the late 19th century in terms of significance for international peace and stability (Liao, 2010; Evans-Pritchard, 2013). Newly-unified Imperial Germany's immediate geographic environment included other, established Great Powers. China, on the other hand, is in effect a civilization pretending to be a state according to the oft-repeated observation of Lucian W. Pye (Zhang, 2011; Pye, 1990). Its humiliation by Japan and the European powers is understood as occurring during a comparatively brief period within the millennia of history during which China was paramount. Hostility to imperialism became a defining feature of modern Chinese nation-state identity (Cottam and Cottam, 2001: 84).

In sum, scholars debate over whether or not US hegemony has been necessary to create a permissive environment for postwar European integration (Schmidt, 2008: 272-73). In East Asia, for liberal intergovernmentalism to succeed, it is less likely to be effective if led by the East Asian actors themselves. This political context of much greater state power inequality makes US regional leadership a necessary, but not sufficient condition, for it to occur. US leadership can override the security dilemma in

Asia and provide the national security public goods that will allow the serious possibility for liberal intergovernmentalism (Dong, 2013). Germany's defeat in two world wars established that Germany did not have the power capability to integrate Europe within an imperial status hierarchy with Germany at the pinnacle. China is rapidly becoming a developed nation state. That the Chinese authorities would be convinced that China is not the naturally preeminent power in Asia, solely by comparison with the power capabilities of only its geographic neighbors, is unlikely.

The comparatively overwhelming power capability base of China in East Asia makes prospective Cold War-type containment of a belligerent Chinese government especially problematic. The Chinese authorities have achieved relatively intensive integration into the global capitalist economy in comparison with the USSR. These facts make the US adoption of an accommodation strategy more likely. Currie suggests such a strategy may risk re-enacting the failure of "appeasement" now in the form of the Obama administration's "strategic reassurance" of China (2009). An appeasement strategy should not be seen automatically as a recipe for disaster today because of the history leading to the outbreak of what become the Second World War (McKercher, 2008: 411, 14, 423-24). Layne highlights neoclassical realism's emphasis on the particularity of German domestic political and individual (i.e. Hitler) factors in an appropriate critique of the UK's "appeasement" strategy (2008, 401). Layne places his position in contrast to the excessive focus in structural realism/neorealism, the predominant paradigm in Cold War international relations theory, on international political systemic factors. Neorealist approaches focus on the shifting international balance of power among European states in the 1930s (Ibid.). A policy-relevant, useful critique of 1930s UK grand strategy or the grand strategy of any state at any time must give equal weight to other factors at the state and individual decision-maker levels of analysis. An accurate assessment of interacting domestic and international political dynamics shaping Chinese foreign policy motivation are necessary to determine the appropriate strategic responses to China's rise. Nationalism is a critical state-level factor shaping the behavior of regional and external state actors in East Asia.

Regional Identity and International Multilateralism

Containing China is problematic because China's disproportionate power capability makes conceptual construction of Asia as a civilization distinct from China cognitively improbable. In contrast, few would argue that a European political identity is not conceivable without Russia as a critical component of it. This point highlights that successful soft power strategies in Europe accommodate national component communities who are roughly comparable in terms of their respective power potential bases. China, by contrast, does not have viable potential Asian competitors that can mandate accommodation. Rather, China's main self-evaluation yardstick is likely to be other global powers, such as the US, or more broadly, the West. The European Union has become equated with Europe and being European as the Bulgarian case illustrates. No such organization exists in Asia that Asians seek to join to prove themselves Asian. Being Asian is not a goal of social mobility and creativity as is being European by joining the EU. Europe consisted of most of the leading powers in world affairs until the end of World War II. The reconstitution of Europe has happened under the hegemonic dominance of a European descendant polity, the United States. Two of the major power victors in World War II and the Cold War are also located in west Europe. As the form of the Western alliance during the Cold War, the North Atlantic Community appears to be the core of a civilization espousing economic and political liberalism for the West (Huntington 1993).

The apparent alliance of Euro-Atlantic structures with national self-determination aspirations of European nations helped solidify this appeal. Soviet Communism in East Europe initially generated significant appeal particularly among lower socio-economic classes experiencing rapid social mobility (Parkin 1969). As economic development slowed and stagnated, the costs of Communism and Soviet authoritarian hegemony became more apparent as well as resented. West Europe's apparent postwar success won the battle for association in the mind of world observers to represent European national aspirations. The cost of American hegemony for most of the peoples of Europe did not appear high. Exceptions include Serbia and its frustration by US-led NATO of its efforts to undo Tito's dispersal of much of the Serb population and claimed territory among neighboring Yugoslav federal entities (Cottam and Cottam, 2001: 219-20). The Russian empire also had a disproportionate potential power base. Historically, the Russian authorities attempted modernization by adopting prevailing west European norms and technologies since at least Peter the Great (Massie 1981). Today, modernization in Europe has become equated with Europeanization, and Europeanization means joining the EU (Anastasakis, 2005: 79).

The Soviet authorities sought to legitimate their policies as achieving modernization by improving upon Western models through application of a superior Marxist social scientific paradigmatic framework (Sakwa, 2013: 79). The Russian empire's relative potential power differential advantage over its neighbors was never as great as China's in spite of what it could have become. Certainly this potential was recognized. One of the contributing factors to the outbreak of the First World War was the concern of the German imperial authorities that waiting would only allow more time for the Russian empire to strengthen [Jarausch, 2012 (1969): 53]. China's modern era great power competitors in East Asia, however, were not serious threats until the nineteenth century. The expansion of Russia, the rise of Japan and the arrival of European imperialism then led to a period that the authorities perceive today as one of national humiliation (Carlson, 2009: 22; Cottam and Cottam, 2001: 84). In the pre-modern era, China was the cultural, political and economic center of its periphery states in the eyes of itself and of the rest of the region until the nineteenth century (Kim, 2013: 236-37). A comparable regional status hierarchy had not existed in Europe for many generations. Kim notes that East Asia as a social identity is a construct of Western Europe as part of "orientalism." It had not been utilized by East Asians until their contact with Europe imperialism. "Historically, East Asia, unlike Europe, has never been unified by one empire or one history" (Kim, 2013: 235). Intra-European state mid-range general power equality facilitated the predominance of American influence in west Europe since World War II.

Meanwhile, internal US constituency cultural attachments of varying degrees of intensity with Europe were useful for European diaspora lobbying in the US foreign policy process (Cottam and Cottam, 2001: 23-24; Ambrosio, 2001: 151). The US has provided strong political support for postwar European integration (Burgess, 2011: 6). Jean Monnet and his collaborators were ultimately successful in launching the creation of Europe as an integrating political community that had not existed previously (Burgess, 2011: 8). In doing so, they acted upon their aspiration to reestablish Europe's leading role in the world that Europe had lost because of its internal divisions. Their aim was a political one but also a moral aspiration to begin to change the nature of global international relations (Burgess, 2011: 14-15). Clearly, the task they faced had one of its foundations in the partition of Europe, including core nation states of roughly equal power capability. As yet in Asia, no similar organization representing Asian identity national dignity aspirations exists. The Association of Southeast Asian Nations (ASEAN) represents the national aspirations of Southeast Asian state communities to achieve development and secure independence. China's rise is a source of opportunity for the former and increasingly a possible source of threat to the latter. ASEAN may not be so perceptually appealing to national groups such as Japan and Korea, who see themselves as descendants of political communities that have existed for millennia. The borders of most ASEAN states, by contrast, were drawn by European imperial powers. ASEAN is not likely to become the core of an organization representing the national dignity aspirations of the peoples of Asia seeking proof of their Asian identity.

The EU represents the capability to represent the liberal reconstitution and coordination of core European nation states with American power underwriting it (Herszenhorn, 2013). ASEAN does do not have the soft or hard power potential to make such a plausible claim on behalf of the East Asian region. Partly because of this power capability, Moscow perceives the EU as a significant threatening challenge to its regional role and aspirations in Ukraine and elsewhere (e.g. Markov 2014). Beijing does not view ASEAN per se as a threatening challenge ("ASEAN-China Free Trade Area," 2013). Rather, its ultimate focus is on the US and the US' allies in the US "hub-and-spokes" regional alliance system (Cha, 2009: 158). In contrast to Soviet and post-Soviet Russia, China's regional and global hard and soft power capabilities will prevent such a parallel formation of regional identity-based containment. Asian organizations emerging to play a containment role towards China are unlikely (Solis, 2013a).

US Strategy Towards East Asia

Cold War Roots of US Accommodation of China

A containment strategy assumes that a revisionist state actor needs imperialist expansion to satisfy national grandeur motivations (Cottam, 1977: 115). The latter are a basis for the control system relationship between the authorities and the public. By blocking efforts at imperial expansion despite costly efforts by the aggressive state, the aggressive state regime will face domestic political pressure to change. With the inability to generate adequate domestic control through public appeals to national grandeur sympathies through imperial expansion, the authorities will have to modify the regime. More emphasis on societal material quality of life will require satisfying the utilitarian economic and political participation needs. These goals in turn mandate integration into international trade and financial flows that obviate against radical international revisionism.

The integration of China into international capitalist trade and financial networks is a fundamental differentiation between China, on the one hand, and the old USSR, on the other. In the US prevailing view, Russia is the successor state to the perceived revisionist imperialist state, the USSR. US policy reflects the assumptions prevalent among US policy makers that Moscow aims to reconstitute its first rank power status in world affairs (Roberts, 2013; Tsygankov, 2011). Russia is on probation as the willing successor state to the former USSR. China switched sides during the Cold War to join with the US and its allies. China enjoys greater tolerance in the US in granting leeway to it in imputing non-aggressive motivations for its foreign policy. China allied with the US during a period of intensifying nationalist discontent in the US towards the end of the 1970s. It was evident in the election of Ronald Reagan as US president in 1980 by defeating the incumbent, Jimmy Carter (Howison, 2014: 88-112). Consequently, China acquired an association in the collective imagination of the US with the US' resurgence. In this perspective, the late term Carter administration adopted a more confrontational approach towards the USSR. It did so especially following its invasion of Afghanistan in December 1979, occurring in the midst of the on-going US humiliation during the Iranian hostage crisis.

The Reagan administration intensified this US challenge to the USSR. In the view of the typical Cold Warrior, this US challenge led to the Soviet capitulation that the policies of Mikhail Gorbachev embodied. The prevailing view within the G.H.W. Bush administration was that his "New Thinking" in foreign affairs, along with "glasnost" and "perestroika" domestically, were ultimately Soviet responses to American containment (Brooks et al. 2004). The USSR was unable to meet the American challenge, and so it sought a new, cooperative relationship with the West. The Reagan administration's proposal for a space-based missile defense system, the Strategic Defense Initiative ("Star Wars" in the media) supposedly exemplified this challenge. In this view, US national will and determination during the Reagan administration caused the Soviet Union metaphorically to wave a white flag.

The end of the Cold War and the disintegration of the Soviet Union led to far-reaching international changes as well as revolutionary changes domestically in the former Communist countries. China, however, was at this point on the winning side. China became associated with the winning end game of the Cold War, while integrating itself into global capitalist trade patterns. Chinese Vice Premier Deng Xiaoping's visit to the US occurred on January 29 – February 4, 1979 (Embassy of the United States). It occurred less than four years after the denouement to the US national humiliation by Vietnam with the fall of Saigon on April 30, 1975. It also began less than 2 months before China launched its punitive border war against Vietnam for its occupation of Cambodia. Nearly 11 months later, the Soviet Union launched its military invasion of Afghanistan on December 24, 1979. On the one hand, Soviet motivations may have been primarily defensive in removing an incompetent Soviet client government in Kabul. In this view, President Hafizullah Amin was losing ground to an externally-supported Muslim-led insurgency threatening to destabilize USSR's Central Asian republics (MacEachin, 2008). On the other hand, Soviet motivations may have been primarily aggressive to exploit American weakness in neighboring Iran to advance towards the Middle East (e.g. PBS, 2006). The prevailing view in Washington was the latter, and China was an ally in opposing the growing Soviet threat to US interests in the Middle East.

US Post Cold War Strategy Towards East Asia

In Europe, the US played an important background role in the creation of the conditions for European integration while leading a containment strategy towards the USSR (Burgess, 2011: 8). In Asia, the US should play a leadership role in promoting Asian integration. The application of US power and influence is necessary, if not sufficient, for satisfying Chinese national dignity demands while restraining the potential for growing Chinese national grandeur demands. Asian integration is less likely to happen on the basis of social creativity approaches among Asian peoples alone. Non-Chinese states are more likely to be stereotyped as historically being tributary states to China or as legacies of European imperialism. They are less likely to be accepted by the Chinese authorities as different but equal to a China that accepts this equality among national differentiation. Therefore, successful liberal regional Asian integration will require external involvement. The TPP can help generate this political potential for US grand strategy. An integration strategy towards China assuaging Chinese national dignity demands, i.e. a "strategic reassurance" strategy, should follow (Osnos, 2009).

Note that the US is not publicly pressuring Japan to increase its military spending. The response to the perceived rising challenge from China has been to harness Japanese polity economic interests to attract the rest of Asia. It does so by avoiding a reckless intensification of perception of challenge within the Chinese government that would be a consequence of a marked Japanese increase in its military spending. Japan has heretofore consistently avoided increasing its military spending above 1% of GNP (World Bank). This is notably lower than the European Union average in 2010 of 1.6% of EU GNP (European Defence Agency, 2012). The latter figure factors in the expenditures for those small EU member states that free ride on the security public goods provided by the large EU member states. Media reports note that the US regularly pressures its European allies to increase their defense spending (Vandiver 2013). The evolving US national security strategy in Asia continues to emphasize its own leadership role. It emphasizes using Japanese economic establishment interests to promote economic and political change within the Chinese polity. The result is more of an accommodation strategy towards China while aiming to strengthen politically the more cooperative elements of the Chinese polity through their vested international business interests.

A role exists for the Trans Pacific Partnership potentially in this new national security strategy of the US and Japan for a rising, authoritarian one-party capitalist China. The US again is using Japan, China's largest trade partner, as a power multiplier (Owen, 2012). US strategy may be characterized as relying on the strength and size of the Japanese business community to incentivize continued Chinese cooperation. This cooperative development may contribute to eventual political liberalization under pressure from a globalized Chinese business community. The Chinese authorities want economic development for the well being of their people, but also for national power and dignity. In this sense, the US appears to be emphasizing more of an accommodation-type strategy to China's demands for respect and equal treatment in what is now a global capitalist economic world. Note that the US government criticized Japanese Prime Minister Shinzo Abe's December 2013 visit to the Yasukuni shrine which many East Asians view as a symbol of Japanese imperialism (Hayashi, 2014)

The context for East Asian integration in the midst of security and border disputes includes the notable absence of existing conflicts between Russia and China. This silence is significant considering the brief but intense border war in 1969 between the two countries (Pereltsvaig, 2012). Large-scale border fighting over Damansky/Zhenbao Island and the Ussuri river border between China and the USSR resulted in heavy casualties (Pravda.ru, 2009). Despite the evident weakening of Moscow with the collapse of the USSR, this old, violent conflict issue remains closed. Since 2008, these boundary issues have been formally resolved (BBC, 2008).

This significant case of negative evidence implies that China's current contentious territorial claims ultimately have the US as the ultimate, context-determining target. Specifically, the US is viewed in effect as a challenge to Chinese national dignity needs (Cottam and Cottam, 2001: 127-30). Consequently, an accommodation strategy, recently termed "strategic reassurance," is likely to be more effective in responding to the Chinese challenge (Currie, 2009). Unlike the prevailing view in Washington regarding Soviet foreign policy motivations, China is not primarily motivated by national grandeur, not to mention ideological messianism. Chinese behavior seeks recognition through confirmation of its equal status with the US within the international system.

Dunne argues that recognition indicates the existence of a social practice, because recognition is fundamental to an identity relationship. China was denied sovereign statehood until January 1942, when Western states finally renounced the unequal treaties. Membership in international society in the nineteenth century was determined by a "standard of civilization." It set conditions for internal governance that corresponded with European beliefs and values. China was therefore part of the states system from the Treaty of Nanking in 1843 until 1942, but it was not a member of international society (2008, 272). This point is noteworthy regarding the foreign policy motivation of satisfying national dignity demands (Cottam and Cottam, 2001: 127-30). Indeed, it is a perspective that highlights national dignity as a primary motivation for international relations for a government authority that attempts to claim that it represents a nation.

National dignity struggles may include spiral conflicts that have at their root a demand for equal prerogatives that are equated with equal treatment. However other actors may (mis)interpret these policies as imperialism/revisionism. Consequently, the English School in the academic field of international relations is seeking to understand the roots of a particular category of international conflict (Dunne, 2008). Historical examples include the outbreak of World War I, in which a rising imperial Germany acted belligerently to obtain equal status in international relations through acquisition of imperial possessions. Germany's belligerency was (mis)interpreted by its opponents as an indication of German radical revisionist/imperialist intentions (Murray, 2010: 658). Comparison of the lead up to World War I with China's rise and the reaction of the US and its allies, depending largely upon their interpretation of China's motivations, has been a theme in political commentary (Blumenthal, 2009; Abe, 2014).

Given the improbability of creating an Asian identity club from which China may be excluded, a containment strategy towards a China perceived as aggressive is likely to lack a useful tool. The option of cultural containment will be less likely available to the US and its Asian allies towards China than it was towards the USSR. Indeed, George Kennan at the beginning of the Cold War had advocated US soft power appeal as an emphasis in containment of the USSR in the competition for world influence (Kennan 1947). Moreover, the US' west European allies during the latter Cold War era were willing to become economically interdependent with the USSR, despite the Soviet SS-20 and US Pershing II nuclear missile upgrades (Tanner 1983). Western Europe imported large amounts of Soviet fossil fuels, notably natural gas through pipelines, while the US exported large amounts of agricultural products to the USSR. The Cold War had embedded itself into the American national security establishment during the first 20 years after World War II. It would continue to be a source of symbolic attention for the next 20 years, but American policy actions belie the intensity implied by American rhetoric. American agricultural exports dropped after the Soviet invasion of Afghanistan, but they resumed after the Reagan administration assumed office in 1981 ("Afghan Boycott"). This inconsistent behavior highlights the challenge of reevaluating assumptions regarding ultimate foreign policy motivations while old assumptions have become institutionalized. The People's Republic of China, on the other hand, has ensconced itself into the business strategies of thousands of American multinational corporations as part of the global production chain (Deloitte 2013). China's advocates in Washington therefore include far more American multinational corporations, which do not take China's communism as a threat to their investments.

For these reasons, China is far more unlikely to emerge as a perceived, unifying threat to the interests of the dominant components of the American establishment. For all of these reasons, an assertive China, in other words, is not likely to lead to Asian integration parallel to the European process with a foundation in American commitment to containment. As already noted, an additional factor exists that obstructs incentives for intra US alliance Asian coordination towards China in contrast to west Europe. This obstacle consists of regional suspicions regarding Japanese foreign policy motivations. European integration occurred while west Europe's nation with the largest economic potential was occupied and divided during the Cold War. Hundreds of thousands of foreign soldiers were stationed along the internal German border. A multitude of nuclear weapons were deployed against each other. Compared with Japan today, West Germany was not seen as a serious potential threat while divided and occupied. West German foreign policy reflected the authorities' awareness that their security situation was precarious. Germany's economic reconstruction as well as long term economic prosperity also required economic trade with its neighbors, recently subject to Nazi imperialism. In sum, Germany was generally perceived as having sufficient motivation to support European Union integration with its obligation of German bankrolling of the project (NPR, 2010; Oudenaren, 2010: 21). Germany repeatedly and publicly accepted responsibility for crimes committed under the Nazi leadership that included paying tens of billions of German marks to Nazi victims. Germany and German economic actors continue to pay these reparations and continue to be subject to additional demands (Daley, 2013).

In South Korea and China, by contrast, Japan is viewed as unwilling to accept satisfactorily the responsibility for the war crimes under the Imperial government (Spitzer, 2012). The postwar Japanese nation's security considerations are also significantly different from postwar Germany's. Japan's existence as an archipelago reinforces a view of dependency on good relations with at least the US and its allies to access vital international export markets. Yet Japan lacks the precariousness of West Germany's postwar situation to convince its neighbors that Japan has a vital interest in reciprocally ceding its state sovereignty in cooperation with its neighbors. Japan is comparatively hesitant to accept public responsibility as the guilty party for the Pacific war and the crimes committed during it. This hesitancy, in comparison with Germany, is evidence supporting this doubt of the feasibility of Japan ever having the commitment to integrate cooperatively with its neighboring states. Consequently, it is another factor indicating a functional requirement for another actor external to the region to play the leading role in promoting East Asian integration.

The contrasts between China and Russia's experience with liberal multilateral institutions are evident further in China's stated interest in possibly joining the Trans Pacific Partnership (Bloomberg, 2013). Chinese commentators raised this possibility again after Japan stated its intent to join these negotiations, which it did in July 2013. This rhetoric is significant in the context of the worsening relations between China and Japan over the Senkaku/Diaoyu islands. The possibility of Russia joining the EU is today absent from establishment discourse. The Trans-Pacific Strategic Economic Partnership Agreement began as an initiative of three small states, Chile, New Zealand, and Singapore, launched in 2003 (Fergusson et al. 2013: 23). The US embraced and endorsed it at the November 2009 summit meeting of the Asia Pacific Economic Cooperation in Singapore (Brown, 2010). One media report noted skepticism regarding the political feasibility of incorporating Vietnam into the TPP due to human rights issues regarding its labor force (Beattie, 2010). Since this report, the TPP moved forward rapidly to include Vietnam (Viet

Nam News, 2010). Peru and Australia also initiated negotiations to join the Trans-Pacific Strategic Economic Partnership Agreement in November 2008 at the same time as Vietnam. All three did so two months after the US initially expressed interest in joining the negotiations (James, 2010). In July 2013, Japan formerly joined the TPP framework of negotiations (Council on Foreign Relations, 2013). As a consequence of Japan's accession to the negotiations, South Korea reiterated its interest in joining the TTP as well (Seok, 2013). This possibility has emerged despite potential complications for its trade liberalization agreement negotiations with China (Kyodo News International, 2013). The 12 countries currently participating in the TPP negotiations are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam (Kyodo News Service, 2013).

China as Strategic Competitor (Bush II) Versus China As Strategic Partner (Obama)

The absence of a formal multilateral security architecture underpinning the TPP akin to NATO for the EU is not an obstacle to Asian integration. In fact, it removes an obstacle to integration since such a construction would risk instigating a more suspicious, assertive and belligerent China in a spiral conflict. China's influence is not likely to be as weak as Soviet influence. China long ago stopped being portrayed as a revisionist state like the USSR was envisioned from the start of the Cold War until its conclusion, at least among the US establishment. Nationalist movements among Asians more readily can find social creativity opportunities without a regional multilateral security alliance rather than with it. This potential exists because of the integration of the very large Chinese nation state into the global capitalist political economy alongside the extended US military presence in Asia. US establishment policy circles portray South Korea's accession to the TPP negotiations as in fact likely to accelerate economic trade liberalization between China and South Korea (Solis 2013b, 16-17). Soviet power capabilities did not include the economic components necessary to integrate peacefully its developed neighbors. National self-determination has to be the keystone for regional integration, including national economic development. A formal, US-led multilateral regional security architecture in Asia would be more prone to generate perceptions that the TPP is a tool for coordinating the civilian power side of US allies in Asia. The EU is so arguably seen in Europe. As such, Russia views the EU as a derivative actor that is a product of the Cold War and is a handmaiden of NATO (Cottam and Cottam, 2001: 248). Unlike the EU, the TPP is not a multilateral actor. The regional response to the rising challenge from China will not as strongly emphasize a coordinated regional military foundation as emerged during the height of the Cold War in Europe. In other words, an Asian integration is unlikely to look like a European Union, even though the Asians may look to the EU as an example or model.

As a policy recommendation, intense US involvement should be viewed as desirable. In one scenario it may conceivably help empower domestically the Chinese central government to exercise control over the vast expanse of Chinese bureaucratic agencies (Buckley, 2013; Perlez, 2013b; "China's New Agenda" 2013). They fight turf wars internally and competitively expand their de facto respective policy jurisdiction internationally including in the East and South China Seas (International Crisis Group, 2012). In this regard, the presence of significant US forces in Asia can help mobilize central Chinese political oversight to generate greater coherence in Chinese foreign policy. By inference, an increased military presence of the US in the South China Sea does not per se mean a worsening of US-Chinese relations (Brummitt, 2012). Comparatively, Russia acquiesced to and eventually accepted Euro-Atlantic intervention in the Balkans for regulation of Balkan conflicts (Milenkovic, 2013). Effective US strategic involvement in East Asian territorial disputes can reinforce the collective awareness of global interdependency. It can include security interdependency along with economic interdependency. This consequent growing bargaining leverage that these actors have over each other is a more sophisticated approach to understanding the US role in East Asia. It stands in contrast to the reference to the need to "counterbalance" China, not to mention contain it (Manning, 2013).

To help maintain peaceful relations through strategic engagement with China, the US would wisely ratify the United Nations Convention on the Law of the Sea (UNCLOS). China has already ratified this treaty-based regime for regulating and resolving sea border disputes. The US administration signed the treaty but never submitted it to US Senate ratification, partly because it would not receive such ratification (Patrick, 2012). Nevertheless, the glaring implicit declaration that the US authorities do not have a consensus commitment to UNCLOS may encourage suspicions in Beijing. Specifically, it raises questions regarding US ulterior motivations and strategic goals in Asia. Meanwhile, the US reiterates that Beijing resolve its sea boundary disputes with its neighbors according to international norms that UNCLOS embodies (Perlez, 2013a).

CONCLUSION

The high degree of Chinese integration into the American-dominated global capitalist trading system has given China exceptional bargaining leverage towards the US. The Euro-Atlantic regional community was critically based around a perceived threat from Moscow lasting 45 years that was accepted at least in Washington, the dominant regional actor. These security concerns built up large vested bureaucratic, military and economic interests both in the Euro-Atlantic region and in the former Soviet Union. They are a product of the competing Cold War grand strategies of Washington and Moscow. Their influence in their respective polities continues. Concern about the lingering resentment in Moscow over its loss of empire generates a shared perception of threat in Europe to national self-determination. It promotes European national social creativity and social mobility as the Bulgarian case illustrates.

China began to move towards a de facto alliance with the US at a later midway point in the Cold War. Unlike NATO, the hub-and-spoke security system that the US created with its clients and allies in Asia avoided the creation of an anti-Chinese club of states to stoke Chinese fears of encirclement (Cha, 2009). It avoided the US allies' horizontal integration around this raison d'etre. The consequences today include greater potential for integration of China into an evolving Pacific regional security and economic system in partnership with the US. The capacity to avoid promoting Asian national social creativity and social mobility on the foundation of intense Chinese-US rivalry is therefore greater than during the postwar era in regard to the USSR/Russia.

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THE ECONOMIC ANALYSIS OF OBESITY

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ABSTRACT

Over the past several decades, obesity has grown into a major global epidemic. Obesity in the United States is widely acknowledged to be a severe and growing problem. In the United States (U.S.), more than two-thirds of adults are now overweight and one-third of the overweight population is obese. There is growing evidence that obesity in America is largely an economic issue. In this paper, we will provide an overview and an economic analysis of obesity based on behavioral economics as a non-rational behavior. Economic costs of obesity are discussed with an emphasis on healthcare costs, as obesity is perhaps the largest medical problem in America. Research to date has identified at least four major categories of economic impacts linked with the obesity epidemic: direct medical costs, productivity costs, transportation costs, and human capital costs. Stemming the obesity epidemic cannot be separated from stemming the tide of poverty and income inequality gap. The obesity issue could be related to rising fast-food outlets and availability of vending machines, too much advertising for unhealthy food, the falling value of minimum wage, government subsidies, income inequality gap, and lack of health and family benefits. These issues need to be addressed through a concerted program of environmental and policy interventions.

JEL: D1, H00, I1

KEYWORDS: Obesity, Medical Costs, Economics, Inequality Gap, Poverty, Food Prices, Diet Cost

INTRODUCTION

Over the past several decades, obesity has grown to be a major global epidemic. According to the Journal of the Medical Association (2010) in the United States (U.S.), the rate of obesity has doubled since 1970 to over 30 percent, with more than two-thirds of Americans now overweight (Hammond and Levine, 2010). In 2010, no state had a prevalence of obesity of less than 20 percent. Thirty-six states had a 25 percent or more; 12 of these states (Alabama, Arkansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee, Texas, and West Virginia) had a 30 percent or more. Obesity is not limited to the United States; most of the world has grown fatter since the 1970s. According to the most recent figures from the National Child Measurement Programme, which assesses the height and weight of primary children in England, just over 33 percent of 11-year-olds are now overweight or obese and among four- and five-year-olds it is 22 percent. The figures are similar in Wales, Scotland, and Northern Ireland (Winterman, 2013). As the median person becomes fatter, it becomes socially acceptable to be fat (Jenkins, 2013).

Causes and consequences of this are beyond the scope of this paper, as it can be very complex regarding heterogeneous population at the individual level. Therefore, we will analyze the issue from an economic point of view; considering the major factors contributing to obesity in general. The first part of this article provides a brief review of literature. Section 2 demonstrate an economic analysis of the obesity with emphasize on role of government and technology in price of food and hence consumption of different types of foods. Section 3 analyzes the relationship of poverty and obesity. Section 4 describes the consequences of obesity. In Section 5 I give an overview of food policy recommendation to fight against obesity and finally, section 6 concludes the paper. The terms “overweight” and “obesity” are used to express weight ranges that are greater than what is considered healthy for a given height. In the case of adults, weight and height are used to calculate “Body Mass Index” (BMI) to define what qualifies as overweight and obese. Obesity in adults is generally defined as a BMI of 30 or greater, with a BMI of 25-

29 categorized as being overweight (Dalrymple, 2010), for more details, see Table 1 on weight range. According to the National Health and Nutrition Examination Survey (NHANES), obesity prevalence in 2007-2008 was 32.2 percent and 35.5 percent among adult males and females, representing a more than 100 percent increase from 1976-1980 and a 50 percent increase from 1988-1994 (Flegal et al. 2010).

Table 1: Weight Range

Height	Weight Range	BMI	Considered
5' 9"	124 lbs or less	Below 18.5	Underweight
	125 lbs to 168 lbs	18.5 to 24.9	Healthy weight
	169 lbs to 202 lbs	25.0 to 29.9	Overweight
	203 lbs or more	30 or higher	Obese

Source: National Center for Health Statistics, 2011

Obesity is not only on the rise among young adults, but also throughout the older population as well. In 2009, nearly one in eight Americans (12.6 percent) was age 65 or older. This ratio is expected to jump to one in five (19.7 percent) by 2030, due in part to longer life expectancies and the aging of the baby boom generation. Because the highest rates of obesity are found among baby boomers, aged 44-62 in 2008, it is likely that the prevalence of obesity among older adults will continue to climb in the coming decades as this population ages. By 2010, 37.4 percent of adults aged 65 and older are anticipated to be obese. If this trajectory continues unabated, it is projected that nearly half of the elderly population will be obese in 2030 (Sommers, 2009). The nation is spending $75 billion a year on weight-related diseases such as; type II diabetes, heart disease, hypertension, high cholesterol, gallbladder disease, and osteoarthritis as merely on the top of the list. Almost 80 percent of obese adults have one of these conditions, and nearly 40 percent have two or more. Authorities view obesity as one of the most serious public health problem of the 21st century (Barness LA et al. 2007). A scary warning comes from the United States, where obesity is considered a real pandemic, in addition to adults; it already involves about nine million young people (Sturm, 2007). At present, obesity is not only a problem from the clinical point of view; it is also a social issue of considerable importance. We are going to review different phases of obesity since 1970s: Phase 1 of obesity began in the early 1970s and is ongoing: average weight is progressively increasing among children from all socioeconomic levels, racial and ethnic groups, and regions of the country.

Today, about one in three children and adolescents is overweight (with a BMI in the 85th to 95th percentile for age and sex) or obese (BMI above the 95th percentile), and the proportion approaches one in two in certain minority groups. Though it has attracted much attention from the medical profession and the public, childhood obesity during this phase has actually had little effect on public health, because obese child may remain relatively healthy for years. Phase 2 of obesity is characterized by the emergence of serious weight-related problems (Ludwig, 2007). The incidence of Type 2 diabetes among adolescents, though still not high, has increased by a factor of more than 10 in the past two decades and may now exceed that of Type 1 diabetes among black and Hispanic adolescents. A fatty liver associated with excessive weight, unrecognized in the pediatric literature before 1980, today occurs in about one in three obese children. Other obesity-related complications affecting virtually every organ — ranging from crippling orthopedic problems to sleep apnea — are being diagnosed with increasing frequency in children. There is also a heavy psychosocial toll: obese children tend to be socially isolated and have high rates of disordered eating, anxiety, and depression. When they reach adulthood, they are less likely than their thinner counterparts to complete college and are more likely to live in poverty.

It may take many years to reach phase 3 of the epidemic, in which the medical complications of obesity lead to life-threatening disease. Poverty and social isolation would complicate the timely identification and management of such problems. Shockingly, the risk of dying by middle age is already two to three times as high among obese adolescent girls as it is among those of normal weight, even after other lifestyle factors are taken into account (Ludwig, 2007). Obesity is implicated in 300,000 premature deaths per year in the United States, which is somewhat less than the number associated with tobacco use, but substantially more than the numbers associated with alcohol and illicit drug use (Chou et al. 2004). In addition to physical ailments, obesity has been found to be related to lower satisfaction with work, family relations, partner relationships, social activities, and depression (Stutzer, 2007).

Review of Literature

There has been an increase in the prevalence of obesity amongst both genders of all ages and ethnic and racial backgrounds. According to the National Association of School Nurses, obesity has more than tripled among adolescents in the past 20 years, and 33 percent of students today are obese or overweight, with related mental and physical health issues, including depression and the growing number of Type 2 diabetes cases (Table 2).

Table 2: Health Issues among All-school-aged Children in U.S.

Obese, Overweight, 32%	Asthma, 10%
Vision deficiencies, 24%	Food allergies, 5%
Prescribed medication for more than 90 days, 13%	Seizure disorder, 5%
Mental, emotional or behavioral problems, 10%	Hearing deficiencies, 5%
Illness or injury resulting in more than 11 missed school days, 6%	Attention Deficit Hyperactivity Disorder, 5%

Source: National Association of School Nurses and Wall Street journal, September 25, 2012, D3

Published scientific research suggests that obesity is caused by the following: excessive consumption of protein, starch, sugar, and fat; by calories and non-calorie sweeteners; by meals and by snacks; by beverages and by solid foods; by eating in fast-food and in full-service restaurants, as well as by eating at home. The only food that has not been linked to obesity is vegetables and fruits (Rolls, Ello-Martin, Tohill, 2004). Energy-dense foods and energy-dense diets have been blamed for the global obesity epidemic (French, Story, Jeffery, 2001). Energy density of food is defined as the energy per unit weight or volume (kcal/100g or megajoules per kilogram). The frequency of consuming restaurant food was positively associated with increased body fatness in adults. The increasing proportion of household food income spent on food prepared away from home in the United States may therefore help explain the rising national prevalence of obesity (McCrory, Fuss, Hey, Vinken, Greenberg, Roberts, 1999), snacks, sweets, and desserts (Zizza, Siega-Riz, Popkin, 2001), sweetened soft drinks (Bray, Nielsen, Popkin, 2004) and large portions sizes (Rolls, Morris, Roe, 2002) have all been linked to greater obesity risk.

As Americans debate what is most to blame for the nation's obesity epidemic, researchers say they have the strongest evidence yet that sugary drinks play a leading role and that eliminating them would, more than any other single step, make a huge difference (Science Daily). Three studies published in the New England Journal of Medicine represent the most rigorous effort yet to see if there is a link between sugar-sweetened beverages and expanding U.S. waistlines (Brody, 2012). "I know of no other category of food whose elimination can produce weight loss in such a short period of time," said David Ludwig, director of the New Balance Foundation Obesity Prevention Center at Boston Children's Hospital, who led one of the studies. "The most effective single target for an intervention aimed at reducing obesity is sugary beverages" (Ludwig, 2012). Many observational studies by Gary Beuchamp, Barbara Rolls, and Brian Wansink have linked consumption of sugar-sweetened beverages to weight gain in children and to weight gain and Type 2 diabetes in adults (Brody, 2012). The new research goes well beyond those findings. In one study among women followed for four years, consuming one or more of these drinks per day nearly doubled the risk of developing Type 2 diabetes, compared with women who drank less than one a month. Also “increased energy drinks’ calories, may even induce hunger and food intake” (Brody, 2012).

In addition, food choices are made on the basis of taste, cost, convenience, and, to a lesser extent, health and variety (Glanz, Basil, Maibach, Goldberg, Snyder, 1998). Variety refers to the innate drive to secure a varied diet, whereas health refers to concerns with nutrition, chronic disease, and body weight. The authors used a national sample of 2,967 adults. Response rates were 71 percent to the first survey and 77 percent to the second survey (which was sent to people who completed the first survey). Univariate analyses were used to describe importance ratings. Respondents reported that taste is the most important influence on their food choices, followed by cost. Their results suggest that nutritional concerns are less relevance to most people than taste and cost. One implication is that nutrition education programs should attempt to design to promote nutritious diets as being tasty and inexpensive.

Researchers at the U.S. Department of Agriculture (USDA) have pointed out that the American diet is inconsistent with the Food Guide Pyramid (Frazao E, Allshouse J, 2003). The consumption of fat and sweets at the Pyramid's tip far exceeds recommendations compared with the low intake of fruits and green leafy vegetables. The reasons that fats and sweets have come to dominate food supply is they are inexpensive, good tasting, energy dense, and convenient to use. Studies support that limited financial resources may be one reason why people are not eating more healthy food (Darmon, Ferguson, Briend, 2002). They add considerable support to the idea that economic constraints are a major factor in determining the nutritional value of foods purchased. The greater the economic constraints on individuals, the poorer the nutritional quality of foods selected.

The basic idea related to the obesity infrastructure is that "the root of the [obesity] problem lies in the powerful social and cultural forces that promote an energy-rich diet and a sedentary lifestyle" (Brownell, Horgen, 2004). This environment has intensified over the past thirty years by opening more fast food restaurants and more advertising. The authors explore the economics of food and make it clear that the profit motive of the food industry is not consistent with the current nutritional needs of the nation. Simply stated, increased food consumption means increased profits—but increased food consumption is not consistent with the health needs of our overnourished population. The authors expose the role of corporations that sell foods that contribute to the obesity epidemic. Brownell and Horgan (2004) warn that "American children may be the first generation in modern history to live shorter lives than their parents". Health economists have demonstrated that the prevalence of obesity is directly proportional to food prices and access to restaurants (Chou et al, 2004).

They estimated the effects of fast-food restaurants advertising on children and adolescent being overweight. Their results indicate that a ban on theses advertisements would reduce the number of overweight children ages of 3-11 in a fixed population by 18 percent and would reduce the number of overweight adolescents' ages of 12-18 by 14 percent (Chou et al, 2008). Causes range from a lack of education about food, limited cooking skills, and limited money to buy healthier food to longer working hours and marketing campaigns for junk food aimed at kids (Winterman, 2013). Although the dramatic rise in obesity can only be explained by environmental factors, there has been little emphasis on the obese persons' economic environment. In particular there has been little research on diet quality and economics of food choice. The broader problem may lie with growing disparities in incomes and wealth, declining value of the minimum wage, food imports, tariffs, and trade. Evidence is emerging that obesity in America is a largely economic issue (Drewnowski, Darmon, 2005). Jobs have become less strenuous and people must pay a high price for exercise. Calories have become relatively cheaper and exercise has become relatively more expensive. Rising obesity rates reflect an increasing unequal distribution of income and wealth. It is by now widely accepted that income poverty is a risk factor for premature mortality and increased morbidity (Subramanian SV, Kawachi I, 2004). Obesity affects poor children disproportionately. Twenty percent of low-income children are obese, compared with about 12 percent of children from more affluent families (Center for Disease Control, 2012). Among girls, race is also an important factor. About 25 percent of black girls are obese, compared with 15 percent of white girls (Ibid). Choice of certain products and eating habits are closely related to preferences, lifestyle, culture, ethnicity, and income level. Since World War II, food tradition and culture of the industrialized countries have suffered a sudden and profound change: of course, economic development has led to greater availability and variety of food, but such availability resulted into greater obesity and diseases associated with it (Neel, 1962). In developing countries the food culture is changing, they tend to adopt eating habits similar to those of the western world, and they are particularly influenced by the industrialized American diet and availability of information and access to packaged food.

In 1989, Sobel and Stunkard published a seminal review of literature on the relation between socioeconomic status (SES) and obesity. These authors covered the 1960s through the mid-1980s and found 144 published studies on the SES-obesity relation in men, women, and children in the developed and developing world. They found a consistently inverse association for women in developed societies with a higher likelihood of obesity among women in lower socioeconomic status. In developing societies, a strong direct relation was observed for women, men, and children, with a higher likelihood of obesity among persons in higher socioeconomic strata. The objective of this paper is to review the impacts of socioeconomic status such as education and poverty on obesity (e.g., body mass index, body weight, and overweight).

Economic Analysis

This analysis is consistent with behavioral economics, the branch of economics that combines insight from economics, psychology, and neuroscience to better understand consumers' situations in which actual choice behavior deviates from the predications made by earlier theories, which incorrectly concluded that people were *always* rational, deliberate, and uninfluenced by emotions. Given the utility maximizing rule, the consumer allocates his or her income so that the last dollar spent on each product yields the same amount of extra utility. The rational consumer must compare the extra utility from each product with its added cost (that is, its price). Obesity is the result of individual decisions to choose poor diets and poor life-behavior patterns (including exercise). Unlike in the rational obesity model, these are not decisions of rational economic men or women. The obese person evaluating the long-term expected benefits and costs associated with his or her diet and exercise pattern and choose a combination that leads to obesity. If these benefits and costs were to change, it would be expected that the individual would change his or her diet and exercise pattern accordingly. These expected benefits and costs might change because of changes in external conditions or changes in the individual's preferences.

Technological advancement has led to lower food (or calorie consumption) prices and higher exercise (or calorie expenditure) prices. First, the relative price changes for different types of food have been quite different. Although the price of food relative to other goods has declined by 16 percent since 1960, the prices of fresh fruits and vegetables, fish, and dairy products have increased relatively since 1983 (Finkelstein and Zuckerman 2008). Analyses of price increases during the period of 1985-2000 for food in different categories shows that cost of sweets, fats, and caloric beverages fell substantially in relation to fresh vegetables and fruits (Economic Research Service of the USDA, 2002). Retail price of fresh fruit and vegetables increased 120 percent while price of fats and oils increased by 38 percent from 1985-2000 (Ibid). In February of 2013, the CPI for all fresh vegetable rose 6.3 percent over the previous year. If anything, these trends accentuate income-based disparities in the access to healthy diets. The indices were constructed so they would each equal 100 during the 1982-84 base period. Over the course of 27 years, the fresh fruits and vegetables index rose 49 percent. By contrast, the price index for cakes, cupcakes, and cookies increased until the early 1990s, and then decreased, leaving it 6 percent higher in 2006 than in 1980. In 2006, the fresh fruits and vegetables index stood 40 percent higher than the index for cakes, cupcakes, and cookies. The graph suggests that prices for healthy fresh fruits and vegetables are diverging from those for less healthy cakes, cupcakes, and cookies.

The government has poured billions of dollars into dietary campaigns. Agricultural subsidies undercut those efforts by skewing the market in favor of unhealthful calories. Much of the food we have to choose from and how much it costs is determined by Conservation and Energy Act of 2008, known as the "Farm Bill." Federal support for agriculture began during the Great Depression, as a temporary support to farmers, paying them extra when crop prices were low. Nearly eight decades later the benefits flow primarily to large commodity producers of corn and soy, which are as profitable as ever. The current bill gives some $4.9 billion a year in automatic payments to growers of such commodity crops, thus driving down prices of corn, corn-based products and corn-fed meats. Cows that are raised on corn, rather than grass, result in meat that is higher in calories and contains more omega-6 fatty acids and fewer omega-3 fatty acids – a dangerous ratio that has been linked to heart disease~~s~~ (Scientific American, May 2012).

Cheap corn has also become a staple in highly processed foods from sweetened breakfast cereals to soft drinks. Between 1985 and 2010 the price of beverages sweetened with high-fructose corn syrup dropped 24 percent, and by 2006 American children consumed an extra 130 calories a day from those beverages (Ibid). Over the same period, the price of fresh fruits and vegetables rose 39 percent. For families on a budget, the price difference can be decisive in their food choices. Thus, the evidence supports the view that it is the relative decline in price of unhealthy foods, not food in general, that has contributed to obesity (Tomer, 2011). The key factors contributing to lowering food prices in general are technological changes and government subsidies. Thus the lower the cost of calorie intake and the higher the costs of burning calories via exercise are important factors of obesity. Consider the influences deriving from food suppliers, in particular the agricultural, food processing, food distribution, and food preparation industries, especially the food processors and food preparers. There is a great deal of evidence that they are increasingly selling unhealthy foods; foods high in bad fats, sugar and sugary items, processed food, and junk food. Healthy foods in contrast are whole, unprocessed foods, full of fiber, antioxidants, vitamins, minerals, phytonutrients, and healthy fats (Hyman 2006).

A USDA study showed that low-income households spent approximately $1.43 less per person per week on healthy food such as fruit and vegetables compared with higher income households (Blisard, Stewart, Jollife, 2004). While higher income households did increase fruit and vegetable consumption after an increase in income, lower income household did not. One explanation can be that fruits and vegetables were not a priority among low-income families and that they chose to spend their limited resources on items that were perceived a more essential such as meat, clothing, or rent.

In general, healthier diets cost more. Developments in agriculture and food technology have made added sugars and vegetable oils accessible globally at remarkable low costs. As a result of added fats, the cost of the daily diet has been maintained at a lower level. Americans have the lowest cost food supply in the world. The typical American diet derives almost 40 percent of daily energy from added sugars and from added fats which are relatively inexpensive (Frazoa, Allshouse, 2003). Given low price and tasty low quality food, marginal utility per dollar of low quality food can be high and that can lead to higher consumption. Diet quality is influenced by socioeconomic position and may well be limited by financial access to nutrient-dense foods. Considering globally, Americans have the lowest-cost food supply in the world and spend the lowest proportion of disposable income on food. The typical American devotes about 7 percent of his or her spending to food, but the average Indonesian, devotes 43 percent of his or her spending to food (Table 2). People with lower incomes continue to spend much more on food in percentage terms than those with higher incomes. Food accounted for 16.1 percent of spending by consumers with the lowest incomes, according to the Labor Department. Consumers with the highest incomes devoted only 11.6 percent of their spending to food (Wall Street Journal, 2012: A.4.). With the spread of fast food restaurants availability in the developing countries, obesity is also on the rise in those countries as well (BBC news, June 10, 2013).

Table 2: Food as a Share of Total Expenditures, Developing and Advanced Countries, 2011

Developing Country	Food As a Percentage of Total Expenditures	Advanced Country	Food As a Percentage of Total Expenditures
China	32.8%	Austria	11.0%
Guatemala	35.5	Denmark	11.5
India	35.4	Finland	11.19
Indonesia	43.0	France	13.0
Jordan	40.7	Germany	11.4
Kenya	44.9	Ireland	7.2
Kazakhstan	34.9	Japan	14.2
Nigeria	39.9	Norway	12.9
Pakistan	45.5	Sweden	11.5
Philippine	38.7	United Kingdom	8.8
Ukraine	42.1	United States	6.9

Source: http://civileats.com/2011/03/29/mapping-global-food-spending-infographic/

Until recently, no one has seriously questioned whether a low-cost food supply has brought anything but benefits to the United States. However, studies are beginning to link the low cost of foods with the obesity epidemic. One study found that technological advances led to a decline in the price of food, which in turn led to higher energy intakes (Lakdawalla, Philipson, 2005). The drop in food price was said to account for up to 40 percent of the increase in body mass index since 1980 (Ibid). The sad part of this result is that the population subgroups with least resources is more vulnerable to the obesity epidemic and any policy changes in terms of higher taxes on unhealthy food will be punitive measures.

Poverty and Obesity

As the *Economist* magazine notes in its own survey of obesity, "the rich and well-educated have mostly managed to stay slim." Also, it said that obesity is prevalent among the Medicaid and thus is burden to tax payers (Jenkins, 2013). The relationship between obesity and poverty has become more obvious and complex: being poor in one of the poorest countries may be associated with poor nutrition, while being poor in a developed country could mean a higher risk of obesity. This is confirmed by Sobal and Stunkard (1989): in developed countries, there is an inverse relationship between obesity and socioeconomic status, the higher social classes are able to compensate for a sedentary lifestyle, with more information and sport opportunities, plus they can afford better quality food, organic and less processed. In less developed countries, with a $2,500 GDP per capita, a direct relationship prevails and, excess weight is observed more frequently among the higher social classes (Monteiro et al., 2004).

Existing studies suggest that the high cost of healthier diets may contribute to the obesity epidemic especially among the lower-income group and low-educated group (Tables 3 and 4). At the individual level, obesity rates are linked to low incomes, low levels of education, minority status, and a higher incidence of poverty. Tomer (2011) in his research indicates that socioeconomic groups with low personal capital, low health capital, and low social capital have higher obesity rates than socioeconomic groups with higher endowments of intangible capital. This has been supported by other studies that indicate~~s~~ that higher diet quality, as measured by the Healthy Eating Index, is associated with higher incomes, more education, and with lower rates of obesity and overweight (Henderson, 2007).

According to the following information presented in Tables 3 and 4, during 2007-2009 the percentage of obese individuals has been the highest for low-income families (35.3 percent) and the lowest for higher income family (24.5 percent). Also, a higher level of education is a contributing factor to a better diet and healthy weight, those with less than high school education had higher percentage of obese (33.6 percent) and the one with higher education less percentage of obese (22 percent). This view point is also consistent with Lakdawall and Philipson (2002) findings stating that the obesity problem and poor health status is very much a problem of low-income status.

Although other factors, including addictive personality, stress, and depression, seeking comfort in familiar foods has been among factors leading to higher consumption of sweets and deserts. In addition, physical access to supermarkets and grocery stores, marketing and distribution of healthy foods, urban sprawl, and the time spent commuting to work have also contributed to failure to adhere to healthy diets (Morland , Wing, Diez, Poole, 2002). This implies that people with weak and/or negative social capital are more likely to be vulnerable to the influences from the infrastructure of obesity and the economic incentives from the markets regarding food and exercise.

Table 3: Percentage of Obese Adults by Household Income, 2007-2009

Percentage of Obese Adults by Household Income, 2007-2009	
Less than $15,000	35.3%
$15,000 to $24,999	31.4%
$25,000 to $34,999	29.6%
$35,000 to $49,999	29.1%
$50,000+	24.5%

Table 4: Percentage of Obese Adults by Educational Level, 2007-2009

Percentage of Obese Adults by Educational Level, 2007-2009	
Did not graduate high school	33.6%
Graduated high school	30.3%
Attended college or technical school	29.6%
Graduated college or technical school	22.0%

Source: "F As In Fat: How Obesity Threatens America's Future," Trust for America's Health, June 2010.

Tomer (2008) argues that in the presence of strong positive social relationships, people's imbalances are likely to be more muted and less problematic. Conversely, when social capital (SC) is weak and negative, people's imbalances are likely to be more pronounced and problematic. Social capital refers to the capacity that is embodied in an individual's social relationships or the bonds and connections between an individual and others. Social capital is embodied in families, institutions, civic communities, and the larger society. The strength and quality of an individual's SC endowment arguably has a relationship to the person's likelihood of becoming obese (Tomer, 2011).

Consequences of Obesity

Obesity is the second leading preventable cause of death in the United States. Each year approximately 300,000 lives are lost due to the direct or indirect consequences of obesity. Obesity is associated with multiple chronic conditions, such as high blood pressure, high cholesterol, heart disease, and stroke, Type 2 diabetes, uterine, breast, colon and gall bladder cancer. Sleep apnea, arthritis, and depression can also be linked to obesity. There is 50 to 100 percent increased risk of all-cause mortality amongst obese individuals. Around 80 percent of obese individuals have diabetes, high cholesterol, high blood pressure or heart disease. Direct medical costs related to obesity are secondary to preventive, diagnostic and treatment services. Hammond and Levine (2010) measured direct medical costs associated with obesity. They argue that relative medical spending for the obese may be as much as much as 100 percent higher than for healthy weight adults, and nationwide "excess" medical spending may amount to as much as $147.0 billion annually for adults and $14.3 billion annually for children.

Indirect costs focus on premature mortality, higher disability insurance premium, and labor market productivity (morbidity). Mortality costs include future income lost as a result of premature death. Morbidity costs also factor income lost from decreased productivity, restricted activity, and absence from work. As per the indirect costs related to obesity, obese people tend to be less productive than the average healthy person and they are more subject to the phenomenon of presenteeism (the tendency to go to work even if you are not in optimal physical condition) (Finkelstein et al., 2011). There is growing evidence that obese employees have greater rates of absenteeism and presenteeism. In a recent analysis, Finkelstein et al. (2011) combined multiple data sets to quantify medical expenditures and the value of lost productivity resulting from absenteeism and presenteeism for overweight and obese full time employees. The cost of obesity among full-time employees, in the United States, has been estimated to be $73.1 billion per year (Finkelstein et al. 2011), in details: 18 percent due to sick days, 41 percent due to lack of productivity because of health issues, and 41 percent due to general medical expenses. Hence, the hidden or so-called indirect costs related to obesity are a relevant percentage of the total.

There are different estimates of such costs as a result of a confluence of factors such as the date of measurement, representativeness of the sample and the scope of measurement. For example, Thompson et al (1998) took a look at the total cost of obesity to U.S. businesses, differentiating between health insurance expenditures, paid sick leave, life insurance, and disability insurance. The authors estimate that the total non-medical cost of obesity among U.S. businesses was $5 billion in 1994. Of that, $2.4 billion was spent on paid sick leave, $1.8 billion on life insurance, and $0.8 billion on disability insurance.

The economic loss of productivity caused by excess mortality is estimated at $49 billion per year in the United States and Canada (Behan, Cox, 2010). The economic loss of productivity caused by overweight or obesity for totally disabled workers is at $72 billion (Ibid). Behan and Cox estimated that the total annual medically-related cost of overweight and obese individuals in the United States and Canada is caused by medical costs, excess mortality, and disability and is approximately $300 billion in 2009. Medical costs associated with obesity in the United States are estimated to be $170 billion in 2013 (BBB News, 2013). Due to the health consequences resulting from excess weight, the increase in obesity also has profound economic consequences on employers and government: the loss of productivity caused by obese conditions of employees is as high as the medical expenses attributable to such conditions. As per the so-called direct costs generated by obesity, compared to normal weight individuals, it is estimated that obese adults have an average of 19.5 percent more physician visits (Quesenberry, Caan, and Jacobson, 1998, in Finkelstein, E.A., et al. 2011). Thompson et al. (2001) also found that obese adults have 48 percent more inpatient days per year and 1.8 times more pharmacy dispenses.

Food Policy Interventions

Without effective intervention, the costs of obesity might well become catastrophic, arising not only from escalating medical expenses but also from diminished worker productivity, caused by physical and psychological disabilities. Future economic losses could mean the difference between solvency and bankruptcy for Medicare, between expanding and shrinking health care coverage, and between investment in and neglect of our social infrastructure, with profound implications for our international competitiveness. The human costs would be incalculable (Ludwig, 2007).

Although broad consensus exists regarding the dietary and lifestyle habits needed to prevent and treat childhood obesity, we lack anything resembling a comprehensive strategy for encouraging children to eat a healthful diet and engage in physical activity. Such a strategy would include legislation that regulates junk-food advertising, provides adequate funding for decent lunches and regular physical activities at school, restructures in the farm-subsidies program to favor nutrient-dense rather than calorie-dense produce, and mandates insurance coverage for preventing and treating pediatric obesity (Ludwig, 2007). Parents must take responsibility for their children's welfare by providing high-quality food, limiting television viewing, and modeling a healthful lifestyle. Fortunately, with the exercise of both personal and social responsibility, we have the power to choose the shape of things to come.

Food policy interventions at the national and international level may be the most promising approach to making healthy food affordable and accessible to all. The World Health Organization (WHO) stated that the key to maintaining a healthy weight is an affordable supply of fresh nutrient-rich foods. Such access could be facilitated through a combination of agricultural subsides, pricing policies, regulatory action, and consumer education. This approach would require cooperation between government, academia, and the food industry. Many variables influence diet and lifestyle choices. Food prices and income status are important determinants of what we will consume. Other factors such as taste, convenience, age, family size, knowledge, and health status are just as important. There are two main policy approaches to address obesity. One approach is to reduce the demand for products and to change the lifestyle that contributes to obesity. This approach can be achieved by information, education, taxing products and food labeling etc.

The second approach is to reduce the supply side by cutting subsidies of agricultural products that keep the costs low. There have been several suggestions to not only remove the offending foods from the consumers' reach, but also to discourage consumption and promote alternative healthier diets. This can be achieved through imposing taxes on fats and sweets and nutrition can be improved at schools by limiting access to vending machines containing beverages and snacks and regulating the sales of competitive foods. Agricultural policy options include the provision of economic incentives for the production of healthier foods and removal of existing subsides. Recent research has uncovered the baneful influence that corn-based sweeteners have had on America's obesity epidemic. It is estimated that Americans consume 73 percent of corn-derived sweeteners per person per year (Sugarcane Profile, Agricultural Marketing Resource Center, 2010). Michael Pollen (2006) points out; the growth of corn-based sweeteners is a direct result of the government's farm policy, which subsidizes corn production. A basic consequence of economic law is that when something is subsidized, more of it will be produced while calories from high-fructose corn syrup are unhealthier than those from natural sweeteners, such as sugar.

Children spend a significant portion of time in schools making it natural that the eating habits acquired during school years become life-long. In America, 17 percent of children under 20 are obese or about 12.5 million people, according to the Centers for Disease Control and Prevention. The rate has tripled since 1980, has leveled off in recent years but has remained at historical highs, and public health experts warn that it could bring long-term health risks (Tavernise, 2012). It is mostly the result of access to foods that have limited nutritional value which are widely promoted. According to the Center for Disease Control's study, 33 percent of elementary schools had canteen, snack shop, or vending machines in 2006. Most of the foods sold are of poor nutritional quality. Children in the Unites States consume on average almost three times as many calories from sugar-sweetened beverages, compared with Dutch children (Ibid).

David Ludwig (2007), suggesting there is a need for public policy changes, speaks to the importance of both education and regulation. "It suggests that if we want long-term changes in body weight, we will need to make long-term permanent changes in the environment for children" (Ludwig, 2012). Education matters, but it is not enough, it must be accompanied by restrictions that curb unhealthy habits and with environmental changes that foster healthier ones. Soft drinks sold in schools are high in calories and add little nutritional value. Increased consumption of these sweetened beverages is linked with higher incidence of obesity and diabetes. The following steps can lead to significant change in the food environment in schools and eventually cultivate healthy eating habits in children:

1. Sell only high nutritional food in schools consisting of fruits, vegetables, whole grains and dairy products that are non-fat.

2. Distribute water and low or non-fat milk in schools instead of sweetened beverages and fruit juices.

3. Increase the reimbursement rates so that school administration can serve food that has high nutritional value.

4. Provide training to food service staff on nutrition and healthy eating.

There have been few research reviews, however, that have shown an association between linking increased availability of fruits and vegetables to increased consumption.

Menu Labeling

Americans consume one third of their caloric intake from fast foods and restaurants because they are inexpensive and convenient. Consumers are mostly ignorant of the food calories, content of sodium, sugar or fat in the food they eat. People who eat outside of their homes are more likely to consume supersized portions and it has been estimated that adults who eat outside consume 250 more calories per day. Portions served in fast foods and restaurant chains have been increasing since 1970s. National public opinion polls show that around 83 percent of Americans are in favor of menu labeling. Adults often read food labels and make purchasing decisions based on it. Menu labeling provides nutritional information regarding calories, carbohydrates, and fat and sodium content. Currently, restaurants that have this information mostly present it on posters or websites but do not make it readily accessible to consumers when they are making food decisions.

Taxation and Subsidization

A tax placed on a product leads to an increase in its ultimate price. Price increases lead to a reduction in the quantity consumed. This occurs as consumers either cut down or stop purchasing the product. Taxes on items such as alcohol and tobacco have been shown to reduce their consumption. One way to reduce the demand of unhealthy food is to impose tax on items that are most closely associated with obesity. Taxation alone is unlikely to address the problem; however, it does have several benefits. The revenue gained from taxation can be directed towards consumer education, providing exercise facilities and therefore lowering the public costs of health care. Another option is to impose taxes on restaurant franchises, which will ultimately reduce the supply of restaurants. Similar taxes can be imposed on snack vending machine and restaurants. Poor diet by specific populations can be targeted by taxing products in particular locations. According to data from the Rudd Center for Food Policy and Obesity at Yale University, 17 states filed legislation in 2009-2010 to expand soda taxation; two of these states, Colorado and Washington, passed such legislation. There have been studies to investigate the potential for soft drink taxes to combat rising levels of child and adolescent obesity through a reduction in consumption.

Fletcher, Frisvold and Tefft (2010) results, based on state soft drink sales and excise tax information between 1989 and 2006 and the National Health Examination and Nutrition Survey, suggest that soft drink taxation, as currently practiced in the United States, leads to a moderate reduction in soft drink consumption by children and adolescents. However, they showed that this reduction in soda consumption is completely offset by increases in consumption of other high-calorie drinks. In general, tax distorts market functioning and reduces economic efficiency. Proponents of soda taxation argue that it falls into the realm of a "pigovian tax." Such a tax may actually increase total economic efficiency in the presence of externalities from consumption. Therefore, taxing such a good not only increases revenue for the government, but may also improve overall welfare by reducing "overconsumption" of the good. In the case of the soda tax, reducing consumption may reduce average body weight and obesity rates (McGranahan, Schanenbach, 2011). This, in turn, might reduce health problems related to obesity, such as diabetes and heart disease, and could reduce health care expenditures. It usually does not matter whether a tax is imposed on the producers or consumers of a good, because the producers can pass some of the tax on to the consumers, how much of that tax passes on to the consumers depends on elasticity of demand and supply for the product. McGranahan's found out that average household spending on sugar-sweetened beverages (SSBs) is $142 in 2008. In addition, SSBs represent a larger share of the spending of the poor than is true for the overall population. Also, SSBs consumption as a share of total spending falls as educational attainment increases. As a result, a soda tax would likely have a disproportionate effect on the less educated and poor groups.

Whether an increase in soda taxes can have any potential impact on public health, we can review a few findings: a recent study by Fletcher (2010) finds that the soda taxes do not reduce obesity rates. Recent proposals, however, suggest raising the tax rates to levels much higher than those that are currently seen and may, therefore, lead to a different outcome if tax is high enough to affect the price to reduce consumption. Recent research suggests that soda consumption is modestly responsive to price changes. According to Andreyeva, Long, and Brownell (2010), an increase in the soda price of 10 percent would decrease consumption by between 2.7 percent and 8.1 percent (elasticity of .27 to .81). Second, lower soda consumption would need to result in a reduction in overall caloric consumption in order to be effective. An alternative to increased consumption of healthy food is subsidization of healthy foods; lowering their price will eventually lead to an increase in their supply and price.

Research by the University of Illinois's, Chaloupka (2012) and his colleagues found that existing state taxes on sugary drinks have not reduced soda consumption or obesity significantly. But those taxes are relatively small and a heftier tax would probably have some impact, he said. Still, he said people have many other sugar sources apart from sodas – which makes a soda tax different from, say, a tobacco or alcohol tax. Chaloupka noted in the Wall Street Journal, August 13, 2012, that some municipalities have taxed sugary drinks in the form of a license fee. The Richmond and El Monte levies are structured as business license fees imposed on merchants – not as taxes on each drink purchase, meaning it would be up to the sellers to decide how to pass along the added costs. Thus, the effectiveness of imposing tax of sugar sources depends on how it affects the price of the products and hence consumptions.

Gradually some actions are being taken in response to corporate responsibilities on obesity. For instance, Coca-Cola Co., PepsiCo Inc., and Dr Pepper Snapple Group will start displaying their drinks' calories on vending machines next year and pointing consumers toward less sugary versions. This was their latest response to critics who have singled them out for contributing to the nation's obesity epidemic (Vauhini, 2012). Finally, leveling the playing field by extending subsidies and insurance programs more widely to fruits and vegetable producers could be a positive step toward fighting obesity. Any new farm bill should, at the very least, remove the current perverse incentives for people to eat unhealthy.

<u>Access to Healthy Food in Low-Income Areas</u>

There is not equal access to nutritional food for all Americans. Minorities and low income people have insufficient consumption of healthy foods. There are several reasons for this such as increased cost of fresh foods in low income neighborhoods, lack of public transportation to supermarkets, and few supermarkets and grocery foods in low income areas stock healthy foods.

To increase access to healthy foods the following steps can be taken:

1. Tax incentives to attract supermarkets to low income areas
2. Increased access to public transportation
3. Provide incentives to create farmers markets
4. Providing coupons to purchase healthier foods
5. Mechanisms to purchase food directly from farms such as farmers markets, farm stands etc.

One community based intervention showed that WIC recipients who received $10 weekly vouchers for healthy foods increased their consumption of fruits and vegetables.

Roles of Advertising and Technology

Highly processed foods were mostly focused in advertisements. Analysis of data for more than 13,000 children found that there is a significant association between the amount of time children spent watching television and the prevalence of obesity. Diets and Gortmaker (1985) concluded that, among 12-to-17 years old, the prevalence of obesity increased by 2 percent for each additional hour of TV viewed, even after controlling for other variables such as prior obesity, race, and socio-economic status. Also, these hours spend watching television contributed to a sedentary life style and an increased risk for obesity. According to the American Psychological Association, children under the age of two are more likely to accept the advertiser's messages as truthful, accurate and unbiased. Food products mostly marketed to children include cereals, candies, sweets, sodas and snack foods. Australia, Canada, Sweden and Great Britain have adopted regulations that prohibit advertising in programs watched by young children. Media also influences behavior in a positive manner. Options include the reduction or regulation of food advertisements that target children, the promotion of educational programs that promote healthy eating and exercise, and intervention to reduce the time children spend on media and texting.

CONCLUDING COMMENTS

Unlike in the rational obesity model, the individual is not maximizing utility or targeting a particular weight or net calorie consumption. The individual may have some aspirations, but these aspirations are likely to be for a complex combination of health, good looks, and weight. Further, the decision-making outcome will be determined to a great extent by the relative strength of the internal and external factors. If the negative external factors (environment) get stronger over time, as they apparently were during the last three decades, without any significant changes in the internal factors, this would indicate a rising level of obesity as has been observed. Richmond's City Council agreed to put a measure on the November 2012 ballot to charge businesses a penny for every ounce of those beverages they sell in the city. If it passes, it would be the first city tax of its kind in the nation and the first to be approved by voters. Meanwhile, health advocates from organizations such as Yale University's Rudd Center for Food Policy & Obesity are saying the measure could help address the nation's obesity problem. Health advocates believe a passage of the tax could set a model for other cities, even as several local soda-tax efforts in various states have been founded amid heavy lobbying. Already, 30 states, including Texas and Iowa, levy a sales tax on purchases of sweetened drinks, averaging about 5 percent, aimed at curbing obesity and raising money. Reduction in unhealthy beverage consumption is needed to help reduce obesity, especially in the lower per capita income areas that have higher obesity prevalence.

Limited access to supermarkets contributes to the risk of obesity because larger supermarkets are more likely to carry healthy foods at affordable prices. In comparison with smaller grocery and convenience stores, supermarkets tend to offer a greater variety of healthier foods. Overall, the number of food stores in poor neighborhoods is nearly one-third lower than in wealthier areas, and the quality of these stores — their size and physical condition, the range and nutritional content of their merchandise — tends to be poorer (Mantovani et al, 1997). Finally, the influence of technology on how individuals spend their free time has to reducing physical activity levels. Personal computers, cell phones, and the growing popularity of text messaging have all fostered sedentary behavior among Americans. While some people find these devices to be enjoyable or efficient, others note that individuals "pay" for this very utility by reducing the calories they would have expended by walking next door to talk with neighbors or by engaging in leisure-based exercise. Food policy intervention through either public interest groups or through government is the key to fight against obesity. There is no single strategy that can be effective alone and rather a combination of different approaches is needed for success. In preventing addiction to tobacco products, the most effective approach was preventing people from becoming smokers and a similar approach is needed. For any policy to be effective, the complex relationship between etiology of obesity, obesity advocacy, and marketing must be rewired. Marketing can play a key role in changing consumer preferences. This can include health conscious television, radio and internet advertising. No amount of advertising and consumer education would be useful unless we lower the price of healthy foods so low income residents can afford to buy them. The school environment needs to change as eating habits and choices developed in school are going to last a lifetime.

Thomas Farley, the health commissioner in New York City, reported a 5.5 percent decline in the number of obese schoolchildren from 2007 to 2011. Although this number is small, some argue that it is an indication that the obesity epidemic, one of the nation's most intractable health problems, may actually has a reversing course (Tavernise, 2012). Some experts note that the current declines, concentrated among higher income, mostly white populations, are still not benefiting many minorities' children. For example, when in New York City, they measured children in kindergarten through eighth grade from 2007 to 2011, the number of white children who were obese dropped by 12.5 percent, while the number of obese black children dropped by 1.9 percent (Tavernise, 2012). Though obesity is now part of the national conversation with aggressive advertising campaign in major cities in the Unites States, many scientists doubts that anti-obesity programs actually work. Researchers say that it will take a broad set of policies applied systematically to effectively reverse the trend (Institute of Medicine Report, May 2012).

None of this can be accomplished without a policy intervention from the government with support from public interest groups. Stemming the obesity epidemic cannot be separated from stemming the tide of poverty and income inequality gap. Is the obesity issue related to rising fast-food outlets and vending machines and too much advertising or to falling minimum wage, income inequality gap and lack of health and family benefits? These issues need to be addressed through a concerted program of environmental and policy interventions. There is growing evidence that obesity in America is largely an economic issue.

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MICROFINANCE AND POVERTY REDUCTION IN GHANA: EVIDENCE FROM POLICY BENEFICIARIES

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ABSTRACT

Poverty is a concept that applies to all humans and more seriously to people in the developing world. The deadly effect of poverty on the poor necessitated a worldwide research into ways of reducing its impact. An important tool in fighting poverty is microfinance which has gained prominence over the last few decades in countries hardly hit by the menace. Studies have shown that microfinance has produced certain successes in poverty reduction. Other schools of taught argue that microfinance has not had the much touted impact. This study ascertained the impact of microfinance on poverty reduction in Ghana. The study employed economic and social variables such as individual income, household growth, access to education, housing and participation in social and religious activities as benchmarks for measuring the impact. Questionnaires were administered to 60 customers and beneficiaries of microfinance products of two major microfinance institutions in Ghana: Opportunity International Savings and Loans Ltd. and Sinapi Aba Savings and Loans Company Ltd. The study found a positive relationship between microfinance and the benchmark variables and recommended training for beneficiaries to ensure efficient use of funds and creation of sound political and economic environments so microenterprises can thrive.

JEL: O15, O16

KEYWORDS: Microfinance, Poverty Reduction, Impact Assessment, Ghana

INTRODUCTION

Poverty has become an albatross for most countries and individual households especially in developing countries. About one billion people globally live in households with per capita incomes of less than one dollar per day (Morduch, 1999). The grave economic and social impact unleashed on the poor in developing countries led to keen interest on the part of donors, policy makers and practitioners who work very hard to expand access of the poor to microfinance. Even though, microfinance disburse small amounts, if properly harnessed can have a knock-on effect and contribute significantly to the wellbeing of the poor. Microfinance can increase investment among the poor and empower them economically. Currently, the focus of microfinance is no longer on credit for investment in micro enterprises. The attention of the entire microfinance community is on the diverse needs of clients, the broader financial ecosystem and the transformational nature of technology (World Bank Handbook on Microfinance, 2013). The objective of microfinance is not to provide credit for the poor to fight poverty alone, but also to create institutions that will deliver financial services to the poor who are ignored by the conventional commercial banks (Otero, 1999).

In Africa and other developing countries microfinance institutions (MFIs) are the main source of finance for microenterprises (Anyanwu, 2004). In Ghana, microfinance institutions fill a gap created by the refusal of traditional commercial banks to give credit to microenterprises. While traditional commercial banks provide credit based on collateral, microfinance institutions (MFIs) provide credit to the poor who do not provide collaterals. Adjei, (2011) observed that for most micro and small entrepreneurs in Ghana the lack of access to financial services is a critical constraint to the expansion of viable micro enterprises.

According to Aryeetey, (1994, 1996) only six percent of the population has access to formal financial services while a majority of the population are denied access. Interestingly, about 91% of the economically active population in Ghana is employed in the informal sector (UNDP 2007). Ironically, it is this active and major part of the population that is denied credit. Given the devastating effect of poverty on the people of Ghana, successive governments since the 1980s have introduced medium-term national development policy frameworks to direct the implementation of development plans in sectors and districts aimed at reducing poverty and improving the social wellbeing of the people. The Economic Recovery Program (ERP), introduced in 1983, was backed by specific programs such as the Program of Action to Mitigate the Social Cost of Adjustment (PAMSCAD) and the Ghana Vision 2020. These programs were, however, unsuccessful (Asenso-Okyere et al, 1993). Further on, the Ghana Poverty Reduction Strategy (GPRS I, 2003-2005) was formulated to enable Ghana to benefit from a significant measure of debt relief available under the Highly Indebted Poor Country (HIPC) program and to position the country in an improved macroeconomic environment to address critical issues of poverty on an emergency basis. Under GPRS I, special social programs were put in place targeted at the vulnerable and the excluded. (IMF Report on GHANA July 2012). With respect to this, the GPRS I reflected a policy framework that was directed primarily at achieving anti-poverty objectives of the UN's Millennium Development Goals (MDGs).

These intervention programs produced mixed results toward reducing poverty. These included service delivery constraints and the persistence of regional differences in the distribution of key outcomes in the health and educational sectors. Against this background the GPRS II was adopted and implemented over the period 2006 and 2009 with emphasis on growth as a means to accelerate poverty reduction and to eliminate the worst manifestation of poverty, social deprivation and economic injustice, from Ghanaian society (IMF, 2012). Following the GPRS II, the government introduced the Ghana Shared Growth and Development Agenda (GSGDA 2010-2013) to achieve sustain macroeconomic stability while placing the economy on a higher path of shared growth, and poverty reduction. All these steps were attempts by the government of Ghana to fight poverty which has rendered 28.5% of the Ghanaian population poor and live below the poverty line (World Bank Report, 2006). Most of the poor are found in the informal sector which is characterized by lack of access to credit. This cripples development and growth of this sector of the Ghanaian economy. IMF May, 2003 country report observed that weaknesses in the financial sector that restrict financing opportunities for productive private investment are a particular impediment to business expansion in Ghana.

Microfinance is, therefore, a financial sustainable instrument capable of providing capital for and ensuring growth and sustainability in the private informal sector ignored by traditional commercial banks. Microfinance in Ghana is, however, plague with challenges including poor recovery rate, lack of capital for sustainability, inadequate credit delivery and management, inability to reach the most vulnerable and marginalized, regulation and supervision problems as well as high turnover of MFI staff.

The focus of this study is whether microfinance has been able to reduce poverty among the beneficiaries of its products. Social and economic variables employed include individual income, household growth, access to education, housing as well as participation in social and religious activities. The rest of the paper is structured as follows: Section II provides a review of the literature. Section III presents the data and methodology. Section IV provides results & discussion, and Section V concludes the study.

LITERATURE REVIEW

According to Oterro (1999), microfinance is the provision of financial services to low-income poor and very poor self-employed people. To Ledgerwood (1999), these financial services are not limited to savings and credit but include other financial services such as insurance and payment services. Robinson (2001) defined microfinance as the supply of loans, savings and other basic financial services to the poor. To Irobi

(2008), microfinance is an economic development model intended to benefit the low-income part of society. Schreiner and Colombet (2001) defined microfinance as the attempt to improve access to small deposits and small loans for poor households neglected by banks. Thus microfinance is the provision of financial services such as credit, savings, and insurance to the poor who cannot access such services from the formal financial sector. Microfinance has been credited with improving other financial outcomes including savings and the accumulation of assets as well as non-financial outcomes such as health, food security, nutrition, education, women's empowerment, housing, job creation and social cohesion (Afrane, 2002; Barnes, 1996; Barnes and Keogh, 1999; Beck, Demirguc-kunt, & Levine, 2004; Hietalahti & Linden, 2006; Hossain & Knight, 2008; Odell, 2010.

Poverty is a concept that applies to all humans and more seriously to people in the developing world. Poverty is defined as the deprivation of basic necessities of life such as food, shelter, accommodation, and clothing. At a UN Summit on social development 'the Copenhagen Declaration' (1995) poverty was described as a condition characterized by severe deprivation of basic human needs including food, safe drinking water, sanitation facilities, health, shelter, education and information. To the World Bank, (2002), a person is said to be poor when his or her consumption level falls below the poverty line of $1 per day. Narayan et al (2000) identified poverty as being complex and interwoven, including a material lack and need for shelter, assets, money and often characterized by hunger, pain, discomfort, exhaustion, social exclusion, vulnerability, powerlessness and low-esteem. In Ghana, poverty is identified as a composite of both personal and community life situations. On the personal level, poverty is reflected in an inability to gain access to basic community services (Batse et al 1999, Nsiah-Gyabaah, (1998). The Ghana Living Standards Survey (GLSS) of 2005 to 2006 defines poverty using an economic index, where the poor are seen as those "subsisting on a per capita income of less than two thirds of the national average" (Ghana Statistical Service, 2006).

Studies on poverty levels in Ghana reveal that poverty is multidimensional (Nkum and Ghartey, 2000) and vary from rural to urban people, the young and old as well as men and women. To rural people, poverty means lack of food, insecurity, infertility and inability to participate in social activities. Urban dwellers see poverty as lack of employment, inadequate social services, lack of capital as well as lack of skills training (Appiah, 1999, Nkum & Ghartey,2000). Men in Ghana associate poverty with lack of material assets, whereas for women, poverty is defined as food insecurity. The young in Ghana consider the ability to generate income as the most important asset, whereas older men cite status connected to a traditional agricultural lifestyle as most important (Ghana, 1995).

Morduch (2002) carried out a study on microfinance and poverty reduction using independent variables such as assets, education, microcredit, family size and income of household as dependent variable. The study employed the Consultative Group to Assist the Poor (CGAP) poverty assessment tools. The findings revealed a positive impact of microfinance on poverty reduction. According to Littlefield, Morduch and Hashemi (2003) there have been increases income and assets, and decreases in vulnerability of microfinance clients. They reference projects in India, Indonesia, and Uganda that have been able to reduce poverty among the poor and improve their general wellbeing.

Asemelash (2002) in Ethiopia confirmed a positive impact of microfinance on beneficiaries as compared to non-beneficiaries. He showed that microfinance has impacted positively income, asset building, and access to schools and medical facilities in the study area. Goldberg (2005) observed that with introduction of microfinance in Bangladesh, the poor no longer remained as poor. Mawa (2008) confirmed that microfinance is an innovative step towards alleviating poverty. In Ghana, evidence exists on the positive impact of microfinance and generally on women empowerment, increase in respect and decision rights within the family as well as increased self-esteemed (Cheston and Kulhn, 2002). To other writers, microfinance is a poverty alleviating tool, though it cannot solve the problem of poverty overnight

(Brownstein, Fleck, Shetty, Sorensen, & Vadgama, 2007). Siddiqi (2008) was not sure whether microfinance has a positive or negative impact.

DATA AND METHODOLOGY

The research design employed in the study was descriptive research with particular reference to the case study method. The survey was undertaken in September, 2013. The study was conducted to ascertain the impact of microfinance products on beneficiaries of such lending facilities in the Sekondi-Takoradi Metropolis of the Western Region of Ghana.

The population consisted of beneficiaries of microfinance products from two major microfinance institutions: Sinapi Aba Savings and Loans Company and Opportunity International Ghana Company Ltd operating in the metropolis. Opportunity International Ghana Ltd was chosen because of its strategic location in the area. It is branched at the Market Circle close to the market with a many market women and petty traders as its customer base. Again, it is one of the world's largest microfinance organizations with a very large client base. Sinapi Aba Savings and Loans Company previously Sinapi Aba Trust is also a microfinance institution noted for providing lending services to poverty communities in Ghana. A sample size of 60 beneficiaries was selected based on purposeful sampling technique with the help of operation officers of the microfinance institutions. This helped ensure effective coverage and reduce time spent and cost.

The main instrument used for gathering data was a structured questionnaire titled ''Microfinance and Poverty Reduction in Ghana; Evidence from Policy Beneficiaries.'' Questions were structured with the objectives of the study in mind. It consisted of items that generated data for answering the research question. The questionnaire had three sections; Section A covered demographic information, Section B captured questions on type, purpose, size, duration and motivation of the facility. Section C concentrated on the impact of microfinance on specific social and economic variables such as income levels, education, family growth as well as participation in social and religious activities among beneficiaries. Validity of the questionnaire was confirmed by relying on the comments of two experienced experts. The questionnaire reliability was confirmed through the inter-rater reliability method. The demographic information of the respondents is presented in Table 1.

Table 1: Demographic Information of Respondents

Variables	Category	Frequency	Percentage (%)	Frequency	Percentage (%)
Gender	Males	12	40	5	16.7
	Females	18	60	25	83.3%
Educational Level	Junior High School	19	63.3	16	53.3
	Senior High School	5	16.7	10	33.3
	Higher National Diploma	2	6.7	4	13.4
	Bachelors	4	13.3	-	-
	Master	-	-	-	-
Occupation/ Profession	Petty Traders	13	43.3	18	60
	Market Women	8	26.7	7	23.4
	Farmers / Fishermen	2	6.7	1	3.3
	Transport Owners	3	10	1	3.3
	Teachers.	4	13.3	3	10
Age	21 – 30yrs	4	13.3	2	6.7
	31 – 40 Yrs	16	53.3	11	36.6
	41 – 50yrs	7	23.4	10	33.3
	51 – 60yrs	3	10	7	23.4

This table shows demographic information of the respondents of the two microfinance institutions. On the left are those of Sinapi Aba Savings and Loans Company Ltd and on the extreme right are those of Opportunity International Savings and Loans Company Ltd. A large percentage of respondents were females: 60% and 83.3% respectively. This is consistent with the idea that a large proportion of clients of microfinance institutions are women because women generally are good borrowers.

Table 1 shows the demographic information of the respondents. A large percentage of respondents were women (60% and 83.3% respectively) and most were petty traders and market women. Again, a large portion of the respondents had high school certificates (63.3 and 53.3 respectively). This confirms the belief that most clients of microfinance institutions are not very educated. A large portion of the clients were women confirming the belief that women generally are good borrowers.

RESULTS AND DISCUSSION (SINAPI ABA SAVINGS AND LOANS COMPANY LTD.)

Table 2 shows the purposes for which the respondents contract their credit facilities. Some 53% of respondents said they contracted the credit for business expansion and 37% said they contracted the loan to start their businesses. The remaining 10% used the loan for paying school fees for their children. This shows that a larger portion of respondents depended on micro finance for business start-ups and expansion. Hence, their very survival depended on microfinance. This re-echoes the importance of microfinance to the vulnerable and poor who cannot access funds from the traditional commercial banks.

Table 2: Purpose of Loan

Purpose	**Frequency**	**Percentage**
Start a business	11	37
Expand a business	16	53
Pay school fees	3	10
Pay house rent	-	-
Family upkeep & growth	-	-
TOTAL	**30**	**100%**

The table above shows the purpose for which beneficiaries applied for credit. The results show 11 respondents representing 37% said they contracted the loan facility to start their businesses. Ten percent of beneficiaries said they took the loan to pay school fees of their children. Sixteen beneficiaries representing 53% said they contracted the loan to expand their business. This data confirms the importance of microfinance products to the poor who depend on it to start and expand their businesses for the very survival of their families

Table 3 below shows the impact of microfinance on specific economic and social variables employed in the study. The variables included income levels, education levels, family growth and housing. The study found an improvement in the level of education and the general skill level of respondents and family after microfinance with 80% of respondents confirmed this finding. The remaining 20%, however, said there were no changes in the education and general skill level for themselves and family after microfinance. None recorded a decrease in educational level and general skill level of respondents and family.

Most respondents reported no change in their level of participation in social and religious activities after accessing microfinance. 83% of the respondents confirmed this. The respondents said that even though they accessed microfinance it has not impacted their level of participation in social and religious activities. Further, most respondents said they belong to one or two religious and social organizations and that their membership was not triggered by micro finance. Five respondents representing 17%, however, said their level of participation in social and religious activities improved after microfinance. None of the respondents recorded a decrease in the level of social and religious participation.

Some 28 out of 30 respondents reported of an improvement in family growth rate after micro finance. This represents 93% of the total respondents. With regard to the specific areas of growth within the family, 47% recorded improvement in family health, 26.5% each reported improvement in housing as well as food and security. None of the respondents reported improvement in security.

Table 3 further shows changes in income after the respondents accessed microfinance. Twenty-one out of the 30 respondents representing 70% of the respondents confirmed an increase in their income levels after accessing microfinance. The remaining 30% said that their income levels did not change even after accessing microfinance. None of them recorded a reduction in their income. This data confirms the positive relationship between micro finance and income levels as found by Morduch (2003). With asset-housing, respondents were asked about changes in asset-housing after accessing microfinance. Some 23 of 30 respondents reported an increased asset-housing. This represents 77%. Seven respondents reported no change in asset-housing.

Table 3 shows changes to income levels of respondents after accessing micro finance. Twenty-four respondents representing 80% reported an increase in their income levels after micro finance. The remaining 20% confirmed no change in their income levels after microfinance. None of the respondent reported a reduction in income levels. This data confirm the positive correlation between microfinance and income levels. The study reported an improvement in education and general skill level of respondents and family after microfinance. Twenty-six of the 30 respondents representing 87% confirmed this. Thirteen percent of the respondents reported no change in education and general skill level while none recorded a reduction. Ninety percent of respondents reported no change in their level of participation in social and religious activities. They confirmed that even though they belong to social and religious organizations, their membership was not triggered by access to micro finance. The remaining 10%, said their participation in social and religious activities improved after accessing micro finance.

Twenty-seven of the 30 respondents, representing 90 percent, reported on improvement in the rate of family growth. The remaining 10% reported no change in family growth. On the specific areas of family growth 43% reported accommodation and another 43% reported improvement in family health while 7% recorded improvement in food and another 7% reporting nutrition and security. The respondents further reported a relationship between microfinance and asset-housing. 16 of the respondents representing 53% reported no change in asset-housing while 47% reported increased asset-housing. The data revealed that even though the respondents access micro finance, a large portion of the loans go into businesses and family upkeep and not housing.

Table 3: Impact of Microfinance on the Benchmark Variables

Variable	SINAPI ABA Savings & Loans Company Ltd % Change / after Microfinance	Opportunity International Savings & Loans Company Ltd % Change after Microfinance
Income level	70% (↑)	80% (↑)
Education and general skill level	80% (↑)	87% (↑)
Level of participation in social and religious activities	17% (↑)	10% (↑)
Family growth	93% (↑)	90% (↑)
Asset housing	77% (↑)	47% (↑)

This table shows changes that occurred to benchmark variables of the beneficiaries. On the left are those of the beneficiaries of Sinapi Aba Savings and Loans Company Ltd. and on the right are those of Opportunity International Savings and Loans Company Ltd. Beneficiaries of microfinance products in both institutions improved in their income levels (70% and 80% respectively), educational and general skill level (80% and 87% respectively), family growth (93% and 90% respectively). Generally, microfinance positively improved the lives of beneficiaries. This data resonate the belief that there is a positive correlation between microfinance and poverty reduction.

OPPORTUNITY INTERNATIONAL SAVINGS AND LOANS COMPANY LTD.

Table 4 shows responses of beneficiaries of microfinance products. It is interesting to note that 27 out of the 30 respondents representing 90% reported contracting the loan to expand their businesses while 7%

confirmed that they took the loan to start a business. The remaining 3% said the micro credit was used for family up keep and growth.

Table 4: Purpose of Loan

Purpose	Frequency	Percentage
Start a business	2	7
Expand a business	27	90
Pay school fees	-	-
Pay house rent	-	-
Family upkeep & growth	1	3
TOTAL	**30**	**100%**

The table shows how the respondents used the loans they borrowed from Opportunity International Savings and Loans Company Limited. A larger portion of the respondents (90%) reported contracting the loan to expand their businesses with a few of them (7%) reported starting their businesses with the loans they contracted. The belief that microfinance institutions help beneficiaries to build and sustain their business was confirmed.

Generally, results show that microfinance impacts positively on all the variables apart from level of participation in religious and social activities which was triggered by other factors and not microfinance. These findings are consistent with Asemelash (2002), Littlefield Murduch & Hashmi (2003), Mawa (2008). Again, a majority of respondents reported their expectations were met and they were satisfied with the efforts of the microfinance institutions.

We make the following recommendations to sustain microfinance and make it effective and fulfilling. Education and training should be provided for microfinance beneficiaries on how to efficiently utilize the funds. Interest charged on microfinance products should be reduced. Further, management and staff of microfinance institutions must be given the needed training and education to help build and strengthen the skill, competencies and abilities for effective service delivery. Efforts should also be made to reach the poor who are the target of microfinance policies and programs. Furthermore, since the poor do not have collateral, management and staff should make available to them tailor-made unsecured products. Loan products should be of a longer duration to give beneficiaries opportunities to generate future income out of the borrowed money. Loans should not be callable by the financial institution prior to maturity. Lastly, the Government should create sound political and economic environments for smooth operations and performance. Without such an environment, no business will thrive. Borrowers need sound economic environments to make a return on their borrowed funds.

CONCLUDING COMMENTS

The main objective of this research is to ascertain the role of microfinance institutions in reducing poverty in Ghana. Successive governments in Ghana since the 1980's have put in place medium-term national development policy frameworks to direct the implementation of development plans in sectors and districts aimed at reducing poverty and improving the social and economic wellbeing of the people. The results of these interventions were mixed. We set out to investigate how microfinance has helped reduce poverty in Ghana.

The paper adopted the descriptive research methodology. A structured questionnaire was used to elicit information from the respondents. The respondents were clients who have benefitted from microfinance. The results indicate that those who access micro financing show improved income levels, education levels, family growth and housing. They reported improvements in the benchmark variables and a reduction in poverty levels.

The major limitation of this paper has to do with the sample size of 30 which makes it difficult to generalize the results. Future studies will attempt to increase the sample size to make generalization of the results possible. Again, other institutions such as the Church, Municipal and District Assemblies, and the Capital Market could be explored to find ways around the problem of poverty.

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UNREGULATED MARKETS AND INTERNET FINANCIAL COMMUNICATION: QUALITATIVE AND QUANTITATIVE APPROACHES

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ABSTRACT

This research examines voluntary financial communication on the Internet by companies quoted on Brussels' unregulated markets. In the absence of obligation to communicate, we wish to know if companies quoted on these markets are proactive regarding financial disclosure on their website? We also identify determinants of the level of internet financial communication. Have the characteristics of the SME an impact on this level? What brought the managers of these SME to disclose or not financial information on the Internet? Do companies quoted in Paris disclose more financial information on their websites than those quoted in Brussels? The general methodology of this thesis follows Grounded Theory principles. This paper aims at showing the contribution of an inductive positioning and the complementary of quantitative and qualitative approaches.

JEL: M15, G10, C50, 032

KEYWORDS: Financial Communication, Website Analyses, Internet Financial Reporting, Unregulated Financial Markets, Voluntary Disclosure

INTRODUCTION

On the unregulated market, there is no obligation for firms to engage in internet communication. The absence of obligation regarding internet financial communication leads to the question of the extent of voluntary communications. The stock exchange of Brussels is part of the NYSE Euronext since the 2007 merger of the NYSE Group and Euronext NV. Two unregulated markets: the Free market and Alternext. evolved on the side of the regulated market Euronext. Study of these unregulated markets is interesting because they address list small and medium-sized enterprises (SME) which are an important part of the Belgian economic framework. These markets give SMEs the possibility of a first stock-exchange experience without satisfying all the obligations related to a listing on a regulated market, and offer them a means to raise capital.

The majority of the scientific papers are dedicated to regulated financial markets. To our knowledge the research here is the first to examine unregulated markets in of Belgium.   Our research centers around the voluntary communication efforts. Quantitative and qualitative approaches were utilized in the analysis. The general methodological approach of our research is inductive and draws on principles of Grounded Theory. This article presents issues of financial communication that lead to our research questions. Then we present the methodologies used. Next, results are presented. The paper closes with some concluding comments.

LITERATURE REVIEW

Internet financial communications originally functioned as a legal obligation and was compulsory for listed companies. Since the 1990s, the approach evolved well. Beyond the simple disclosure of financial information, financial communications became an element of firm's global strategies (Westphalen & Libaert, 2009). The exchange of stock takes place according to the law of supply and demand. The product sells the company, even if it is a share. Information communication requires a plan (Heldenbergh &

Scoubeau, 2005). A plan of financial communication must be developed according to the financial objectives of the compan (Malaval, Décaudin & Benaroya, 2009: 496). A distinction is made between financial information which emanates directly from legal obligations governing the publication annual accounts of companies and other financial communication (De Bruin, 1999: 16). Financial communication is a strategic element that is inseparable with financial and stock-exchange marketing (Léger, 2008).Several arguments ague for financial information disclosure. Agency Theory finds application within the framework of financial information disclosure. According to Jensen & Meckling (1976), disclosure of financial information allows one to limit agency conflicts and reduce the agency costs. Transparency aims at reducing information asymmetry and preventing opportunist behavior (Chaher & Gnichi, 2007). Schapiro-Neil (2011: 57) argues that "financial communication aim at limiting the risks attached to the company and at managing the uncertainties of the market".

Signaling Theory allows the company to provide additional information to the market. Debt and dividends are used to communicate the health of the company (Leland & Pyle, 1977). On financial markets, investors ask for a risk premium to compensate for the information asymmetry. By disclosing voluntary information, the company reduces risk associated with its shares and thus decreases the cost of capital (Merton, 1987). Several researches demonstrate the decision of disclosing information is influenced by proprietary costs affecting the information holder. Indeed, the disclosure of information can damage the competitive position of a company (Verrecchia, 2001; Dye, 2001). These studies demonstrate that companies are incited not to communicate to preserve their competitive position. This holds even if raising capital will be more expensive afterward and if investors interpret the withholding of information as a signal of bad news. Financial information is arbitration between disclosing information to the investors and to competitors (Fasse & Schapiro-Neil, 2011: 57).

<u>The Internet as a Tool for Financial Communication</u>

More than two billion persons used the Internet on the 30 of June 2012 compared to 360 millions in 2000. That change represents a 566.4 % growth in 12 years (www.internetworldstats.com/stats.htm). The internet offers three types of tools websites, e-mail and advertising banners. Other means of communication such as blogs, social networks, forums, virtual worlds, online videos, and wikies are also offered to companies (Westphalen & Libaert, 2009). Within the framework of this research, we concentrate on company websites. The website is a " space created by the company to inform and to introduce a relation; the website is the starting point, the heart of the system" (Westphalen & Libaert, 2009: 98). Regarding financial information this new communication tool appeared near traditional communication tools including annual reports, press releases and shareholder meetings. The Internet gives individual investors access, at low cost, to the same information as other investors (Brissy, Guigou & Mourot, 2008). As Westphalen & Libaert (2009: 337) note,

"The Internet participated in the democratization of the stock-exchange life: it offers to the shareholders the real equality of access to the information". The internet presents several advantages over other communication methods (Geerlings et al. 2003; Branco & Rodrigues, 2006; Léger, 2008; Jahdi & Acikdilli, 2009). The internet allows firms to spread a more information, at a lower cost, in a reduced amount of time. Second, the internet allows firms to reach several targets at the same time and send them specific information. Third, information is archived and updated. Thanks to a financial space on its traditional website, a company can present financial information (Malaval, Décaudin, Benaroya, 2009: 481). Andrikopoulos & Diakidis (2007) explain that some possibilities are exclusively offered by the Internet, for example the distribution of videos of shareholder meetings, of roadshows, a storage space, archivings of documents over several years, subscription to a newsletter, a space for dialogue via a forum of shareholders or the possibility of raising questions. A company can choose to disclose financial information to all Internet users, without distinction. However, the communication of particular information with certain targets, such as institutional investors and particular investors, can be an asset for the company

(Heldenbergh & Scoubeau, 2005: 196). The efficacy of a financial information website (Malaval, Décaudin, Benaroya, 2009: 482) can be evaluated by referencing, user-friendliness, personalization, interactivity, information and links. A website stake is “ to inform and to seduce, to explain and to convince, to attract and to develop loyalty" (Léger, on 2008: 92), to anticipate the questioning of investors, to answer in a clear and complete way, to supply to the financial community the necessary information to estimate the company’s value and especially develop a relationship with investors (Barredy and Darras, on 2008: 3).

Context of the Study and Research Question

The Free market and Alternext are multilateral trading facilities (MTF) since November 1, 2007. They are unregulated markets in the sense of European directives or Belgian financial legislation. Listed companies on these markets are not forced to publish their accounts based on IAS / IFRS formats or to conform to the Belgian Code of governance. Rules are established by Euronext Brussels and approved by the Financial Services and Markets Authority (FSMA). On unregulated markets conditions of membership and obligations were reduced to allow companies to concentrate on business development (Euronext, 2006). Table 1 shows some statistics of Brussels unregulated markets. In this table, we see that on the Free Market there are only SMEs and that the managers held a majority of shares. On Alternext, there is majority of SME and the institutional investors held more than 30% of the capital.

Table 1: Some Statistics about Unregulated Markets of Brussels

Data	Free Market	Alternext
Number of firms	24	14
Market capitalization	182.100.00,00€	284.900.00,00€
SME	100%	71,43%
Structure of capital		
Manager	*61%*	*21%*
Manager’s family	*2%*	*1%*
Institutional Investors	*17%*	*36%*
Public	*18%*	*38%*
Others	*2%*	*4%*

Table 1 show the number of firms evolving on each unregulated market of Brussels, their market capitalization and their structure of capital.

To be listed on the free market, the company has to satisfy no preliminary condition, except the approval of the IPO prospectus by the FSMA. To be listed on Alternext, firms have to exist for two years, raise a minimum of 2.5 million euro on the market and choose a listing sponsor who will help the firm prepare the IPO. Once quoted, companies of the Free Market have no legal obligation of information, except the accounting obligations such as disclosure of the annual report. On Alternext, companies must disclose periodic account and information susceptible to influence the stock market price. Furthermore, legislation regarding transparency plans that the Alternext shareholders who hold an important participation, have to communicate this information. They have to indicate to the FSMA, and to the listed company, the crossing of the thresholds of participation of 25, 30, 50, 75 and 95%. Contrary to companies quoted on Euronext, companies evolving on the unregulated markets do not have to have a web site (FSMA, 2012). Pourtier (2004) explains that by defining what is required, we define by default what is voluntary. Given that no disclosure of internet financial information reporting is required, any internet financial communication from listed companies on unregulated markets results from a voluntary effort.

We wish to know if companies quoted on these markets are proactive regarding voluntary financial disclosure. The exploratory study of Arnone, Colot, Croquet, Geerts & Pozniak (2010) was the first to focus the level of internet financial communication of companies quoted on the Free market of Brussels. Thanks to a literature review highlighting the recommendations concerning financial communication on the Internet, the authors created an analysis grid of websites. This grid is used to evaluate the quantity of communication of every company quoted on the Free market at the end of 2008 (27 SME). For every item of the analysis available on the web site of the company, a point is awarded. A final score of financial communication is obtained for each company. The authors of this exploratory work discover that certain elements such as a press review or the board of director's presentation are present, whereas the stock market price and the dividends are rarely communicated. A certain disparity in the level of financial information disclosure between companies is observed. Some companies communicate a great deal of financial information on their website whereas others present very little.

What elements explain these differences of Internet financial communication degree? What are the determiners of the Internet financial communication score? No company shows all elements of the analysis grid on its website. The average obtained score is relatively low. We wonder if this is the due to the fact that they are SMEs. Or maybe it is the case for all companies quoted on unregulated markets. Parris and Brussels stock markets are governed by the same rules so an open question is if the companies quoted on these exchanges present the same degree of communication. Have the unregulated markets a link with the internet financial communication? Finally, the authors (Arnone et al., on 2010) underline the voluntary efforts realized by these companies to disclose financial information on their website. What is the origin of this voluntary effort? What brought these SME to publish financial information on their web site? In Figure 1 show how the explanatory work of Arnone et al. (2010) and their discoveries are the foundation for our research questions.

Figure 1: Research Questions

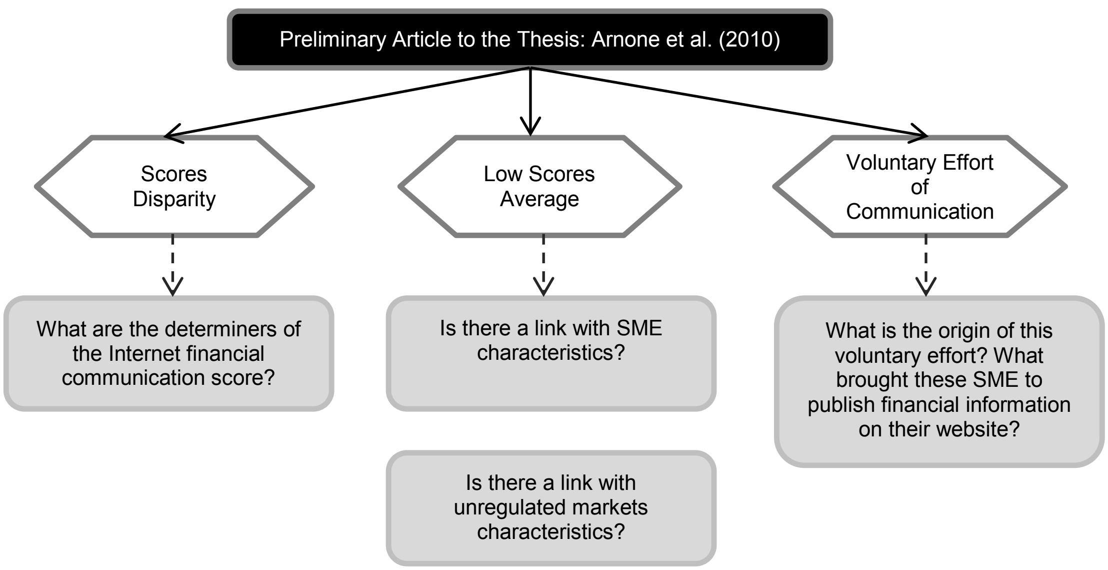


Figure 1 shows the questions, raised up thanks to a preliminary study, which are at the beginning of our research.

METHODOLOGY AND DATA

This section presents the field we analyze in our research and the methodology we use in our four papers. Through these articles we built a thesis dedicated to companies quoted on unregulated markets of Brussels. Article 1, (Pozniak, 2010) studies all companies quoted on the unregulated markets of Brussels in 2009. Article 2, (Pozniak & Croquet, 2011) compare all SMEs listed on the unregulated markets of Brussels to unlisted SMEs. Article 3 (Pozniak & Guillemette, 2013), involved interviewing 10 managers of SMEs listed on the Free Market of Brussels. Article 4 (Pozniak, 2013) compare companies listed on the unregulated markets of Brussels in April 2012 to companies listed in Paris. The evolutionary fields in each research are presented in Table 2. We also indicate when we analyzed the websites and which year of financial statements were used. In Article n°4, we studied 23 firms quoted on the Free Market of Brussels and 23 firms from the Free Market of Paris and 11 firms quoted on Alternext Brussels and 11 firms from Alternext Paris. The websites analyses were done in April 2012. We used the annual accounts of 2010.

Table 2: Study Fields in Evolution

	Article n°1	Article n°2	Article n°3	Article n°4
Analyzes of websites	Feb 2009	Nov 2009	sept-12	April 2012
Financial data	2007	2008	no	2010
Composition of corpus				
SME listed on the Free Market of Brussels	28	26	10	23
SME listed on Alternext Brussels	9	9		11
Unlisted SME		35		
SME listed on the Free Market of Paris				23
SME listed on Alternext Paris				11
Number of SME studied	**37**	**70**	**10**	**68**

Table 2 shows the sample of firms studied in each paper of our research. It also notes when the data were collected.

METHODOLOGY

Each articles of this thesis uses the most appropriate methodology to answer its research question. So articles n°1, n°2 and n°4 use a quantitative approach, indicated when the research aims at measuring, at explaining as well as at testing theories (Cooper & Schindler, 2006). These articles use two methodologies. First, the literature review relative to the recommendations in terms of internet financial communication (Pervan, 2006; Euronext, 2006; Dutta & Bose, 2007; Léger, 2008; Barredy & Darras, 2008) and elements discovered during the consultation of some websites allow the construction of an analysis grid. Thanks to this grid, we analyze company websites and give one point for each item of the grid available on the website (Debreceny & Rahman, 2005; Khadaroo 2005; Paturel, Matoussi & Jouini, 2006; Abdelsalam, Bryant & Street, 2007; Jouini, 2007; Gabteni, 2011). The analysis website contents produces an Internet financial communication score (Allam & Lymer, 2003; Oyelere, Laswad & Fisher, 2003; Xiao, Yang & Chow, 2004; Gowthorpe 2004; Khadaroo, 2005; Lybaert, 2005; Abdelsalam, Bryant & Street, 2007; Oyelere & Mohamed, 2007; Gabteni, 2011). This financial communication score is regressed by means of the explanatory variables stemming from the research hypotheses (Debreceny & Rahman, 2005; Paturel et. al., 2006; Ben Rhouma & Cormier, 2007; Jouini, 2007).

Articles 2 and 4 use the paired samples technique (Thietart, 2003; Evrard, Pras & Roux, 2009; Malhotra, Birks & Wills, 2012; Caby, 1994; Bughin & Colot, 2008). Paired sample implies the two samples are similar with regard to certain characteristics (in this case, the size and the sector) allowing us to assure that the observed effect came from the studied variable (in Article 2, the listing status; and in Article 4, the market of quotation) and not from the difference in sample composition. The structure of samples is a priori controlled to obtain samples presenting identical structures. From then on, errors due to differences in group composition are reduced (Thietart, 2003). Article 3 follows a qualitative approach, adequate when the understanding of the real-life experience of the persons is pursued (Paillé, 2007). Our research clearly defend the complementarity between the quantitative and qualitative methodologies such in a manner similar to other authors (Malhotra, Décaudin & Bouguerra, 2004; Evrard, Pras & Roux, 2009; Gauthy-Sinéchal & Vandercammen, 2010; Baines, Fill & Page, 2012; Lendrevie & Lévy, 2012; Malhotra, Birks & Wills, 2012).

The general methodology of our thesis follows the Grounded Theory. The methodological progress is resolutely iterative and inductive. Each article had the ambition to answer questions raised by the previous article. Research problems are defined at the end of the study (Guillemette, 2006; Evrard, Pras & Roux, 2009; Guillemette & Luckerhoff, 2009; Luckerhoff & Guillemette, 2012; Plouffe & Guillemette, 2012).

Table 3: Methodology of Each Paper

	Article n° 1	Article n° 2	Article n° 3	Article n° 4
Approach	Quantitative	Quantitative	Qualitative	Quantitative
Methodology	Content analysis Linear regression	Paired sample Content analysis Linear regression	Interviews	Paired sample Content analysis Linear regression
Tools	Stata 10.1	SPSS Stata 10.1	WeftQDA	Stata 10.1

Table 3 shows the methodology used in every paper of our research. It also shows the software used.

RESULTS AND DISCUSSION

This section aims at finding answers to our research questions, presented in Figure 1, in the four papers and demonstrate how rich and complementary both qualitative and quantitative approaches are. The first question was the determinants of Internet financial communication level? Article 1, dedicated to companies quoted on unregulated market of Brussels reveal the negative impact of performance and positive impact of the membership in the IT sector on the Internet financial communication score. The market of quotation also influences the score. Companies quoted on Alternext inform more that those quoted on the Free market. Article 2, where unquoted SMEs were matched with quoted SMEs on the Brussels's unregulated market, establishes the positive effect of company size and its quotation and the negative effect of the debts on the level of financial communication through the company's website.

Article 4, where companies quoted in Paris were matched to companies quoted in Brussels, demonstrates the positive influence of size, membership in the IT sector and the market of quotation on the degree of financial information discloser on the Internet and the negative influence of company age. Focusing on the Belgian sample, the variables size, membership in the IT sector and performance have a positive influence on the Internet financial communication score. In the French sample, size and company age have a positive and negative impact respectively on the level of financial information disclosure on the company's website. Through our various researches, certain variables turn out to be recurring determiners of the Internet financial communication score. Size has a positive impact in Articles 2 and 4. Larger firms have higher internet disclosure scores. Besides, managers within the framework of Article 3, talk about low human and financial resources levels they can dedicate to Internet financial communication. In most cases, the manager themselves manage the company's website.

Membership in the IT sector has a positive impact in Articles 1 and 4. IT sector firms have a higher Internet financial communication score. Managers of IT companies in Article 3, demonstrate a approach pushed by the Internet. These companies presented the best scores, except when the manager explained that he fears revealing information to competitors. Influence of performance on the level of Internet financial communication listed in Brussels seems to evolve in time. In Article 1, its impact is negative. In Article 4, its impact is positive. In 2008, more successful companies were suspicious and disclosed less financial information on their website. In 2012 more successful companies disclosed more financial information on the Internet. We notice that Internet financial communication score increases very slightly with an average of items of 12.76 in 2008 (standard deviation 6.13) and 13.21 (standard deviation 6.95) in 2012.

The average performance fell. The average ROE of 4.71% in 2008 (standard deviation 45.85) declines to 3.28% in 2012 (standard deviation 35.12) and the average ROA of 8.18 % in 2008 (standard deviation 11.96) declines to 2.27 % in 2012 (standard deviation 19.42). In this context of economic crisis, we suppose that successful companies realized more financial communication efforts to distance itself from ailing firms and reassure investors. The second question asked concerned characteristics of the SMEs and the link with Internet financial communication level. Do listed SMEs inform more than unquoted SMEs? Article 2 shows that SMEs have a higher level of Internet financial communication compared to their unquoted peers.

However, they have no obligation to disclosing financial information on the Internet, companies quoted on unregulated markets of Brussels realized a voluntary effort of communication.

We also questioned if characteristics of unregulated markets had a link with the level of Internet financial communication. Do companies quoted in Paris inform more that those quoted in Brussels? Article 4 allows produces a negative answer to this question. Companies quoted on Brussels' unregulated markets present a higher level of Internet financial disclosure than their peers quoted in Paris. The voluntary effort of financial communication on the Internet is thus higher among companies quoted in Brussels. This result is contrary to our forecasts. The comments of managers of companies quoted in Brussels (see Article 3) as well as the data of Euronext relative to the Brussels and Paris markets let us identify a higher level of financial communication on the French companies' websites. Finally, we examined what brought managers of SMEs to publish financial information on the Internet. What relation can be established between financial characteristics available on the web site of a SME and elements evoked by the managers? The results of Article 3 confirm the dominating place of the manager in his SME and his influence. In particular with regard to internet disclosure of financial information.

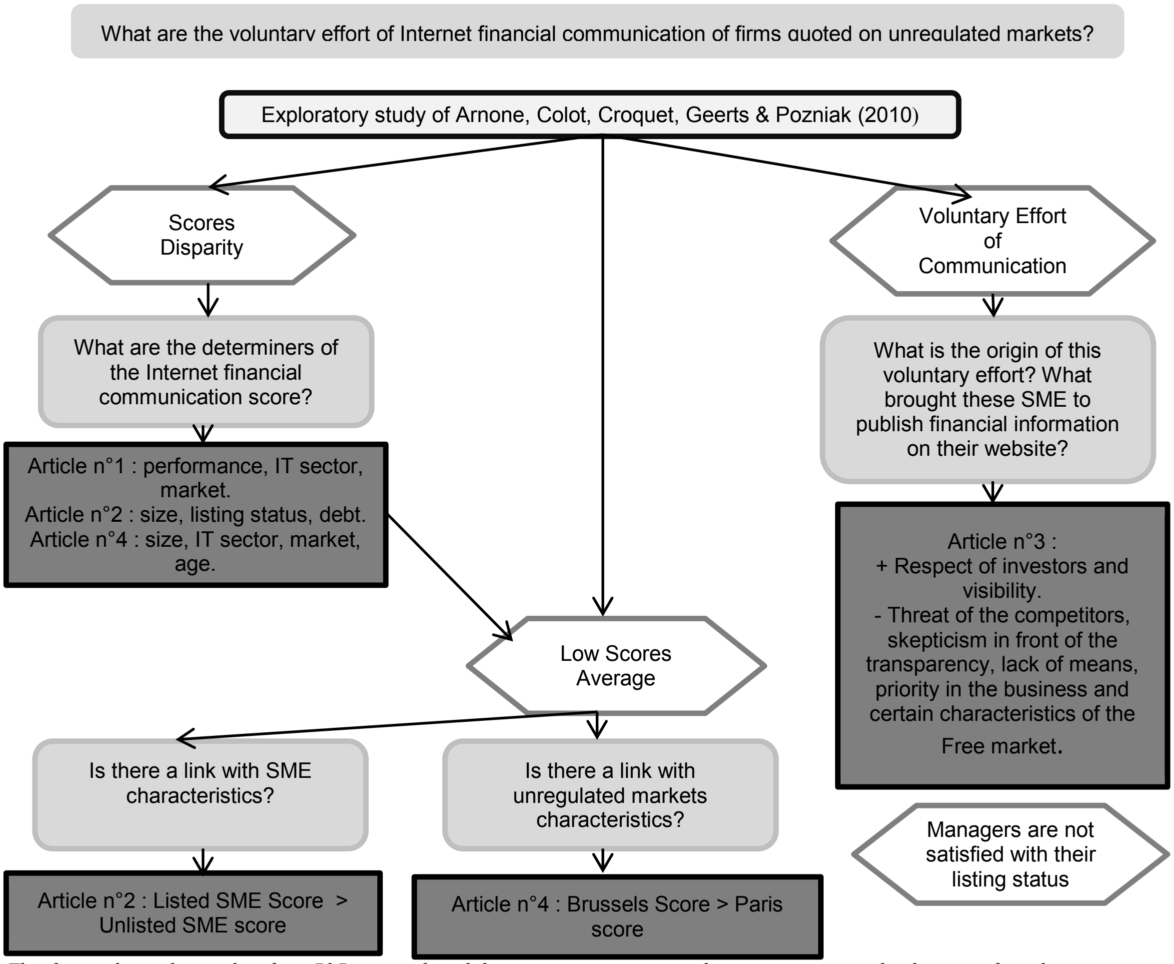
Elements bringing managers to publish financial information on the internet include investors and visibility. Elements, which brought managers not to publish financial information, are the threat of the competitors, skepticism of transparency, the lack of means, the priority in the business and certain characteristics of the Free market. Article 3 reveals that managers fearing the disclosure of information to competitors are those whose web site presents the least financial information. Managers mentioning their will to respect investors present the most financial information.

CONCLUSION

The goal of this research was to study voluntary internet financial communication by firms quoted on unregulated markets of Brussels. We wished to discover what determines the level of internet financial disclosure. We examine if quoted SMEs communicated more than unquoted SMEs We also examine if firms quoted in Paris communicated more than those quoted in Brussels. Finally, we wish to understand what brought SME managers to make a communication effort. To reach those multiple goals, we used qualitative approaches (interviews) and quantitative approaches (content analysis, linear regression, paired sample).

We study all firms quoted on unregulated markets of Brussels. We added unquoted SMEs and firms quoted on unregulated markets of Paris. We also met managers of SMEs quoted on the Free Market of Brussels. Our results show that performance, size and membership in the IT sector are recurrent determiners of internet financial communication level. We discover than quoted SMEs communicate more financial information on their websites than unquoted SMEs. Belgian firms present more internet financial communication than French firms. Finally, we confirm the essential position of the manager in his SME. This research allowed us to identify numerous avenues of future research.

Figure 2: Results



This figure shows the results of our PhD research and the answers to our research questions rose up thanks to our four-thesis paper.

Identification of determinants of Internet financial communication levels could be improved in different ways. Growth potential, measured by the difference between market value and book value does not make much sense for companies quoted on unregulated markets, which present low liquidity levels. This variable was not significant in Article 1 and was not used in the following articles. The age of the company is used only in the last article and is significant only for companies quoted in Paris. It would be more appropriate to take into account the number of years since the IPO and not since the creation of the company. Indeed, several researchers show the impact of listing status on the level of company communication. We could suppose the voluntary effort of communication is more important early following the IPO. Free float, used in articles 1, 2 and 4 to measure the dispersal of capital, is supposed to represent the percentage of capital held by the public and thus the shares potentially exchanged quickly. However, on unregulated markets, liquidity is lacking and shares are exchanged with difficulty. The measure of free float is thus not the most appropriate. We could take into account the percentage of capital held by the manager and his family as the measure of capital concentration. Indeed, some researchers (Labelle and Schatt, 2005) demonstrated that companies controlled by a family tend to disclose less information given that the majority of the shareholders already have the information but also given that the family is afraid of disclosing information to competitors.

The size of unregulated markets of Brussels is relatively small and thus even when we study all the population, the number of companies in the study marginally exceeds 30. In future work we intend to add SMEs quoted on AIM London and AIM Italia

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HOW TO IDENTIFY DISRUPTIVE NEW BUSINESSES

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ABSTRACT

In almost any industry, the most dramatic stories of growth and success were launched from a platform of disruptive innovation (Christensen et al., 2002). The probability of creating a successful, new growth business is 10 times greater if the innovators pursue a disruptive strategy rather than a sustaining one. Genuinely disruptive innovations are the ones that result in the creation of entirely new markets and business models. Few companies have introduced these innovations. Disruptive innovations appeal to customers who are unattractive to the incumbent companies. According to Christensen (2012) companies that want to create new growth businesses should seek disruptive opportunities because industry leaders will not be motivated to pursue them. The successful disruptive innovators always target customers who welcome simple products and affordable. The disruptive business model strategy needs to be sure that it is unattractive to every powerful incumbent. The purpose of this article is to present the concept of disruption from the perspective of a Social E- Commerce company that is the leader in group buying daily deals in Puerto Rico. In four years, Social Media Group obtained 80% of the market share of the group daily deal companies in the island. It achieved sales of $12.5 million in 2011 and $25 million in 2012. The owners are three brothers of less than 30 years old! The chief of operations is only 26 years old. This is an example of young genius entrepreneurs.

JEL: M13, M19

KEYWORDS: Disruptive Innovations, Disruptive New Businesses, New Businesses Models, E-commerce

INTRODUCTION

In almost any industry, the most dramatic stories of growth and success were launched from a platform of disruptive innovation (Christensen *et al.,* 2002). The probability of creating a successful, new growth business is 10 times greater if the innovators pursue a disruptive strategy rather than a sustaining one (Christensen, 1997). Genuinely disruptive innovations are the ones that result in the creation of entirely new markets and business models. Few companies have introduced these innovations. Disruptive innovations appeal to customers who are unattractive to the incumbent companies. According to Christensen (2012) companies that want to create new growth businesses should seek disruptive opportunities because industry leaders will not be motivated to pursue them. The successful disruptive innovators always target customers who welcome simple products and affordable. The disruptive business model strategy needs to be sure that it is unattractive to every powerful incumbent (Dewald and Bowen, 2010).

Social E-commerce is growing at five times the rate of traditional retail channels. New avenues of e-commerce, such as daily deals offered by companies like Groupon and LivingSocial, have boosted the sector's momentum since 2010 (Gridley and Company, 2011, p. 6). The group buying industry has an estimated value of approximately $2.7 billion (Kessler, 2011). This translates into roughly 138% growth in 2011 alone (Kessler, 2011). The rapid growth that both of these companies have experienced in less than five years since their launch dates and the unparalleled pace of adoption and frequency of utilization by consumers, merits an investigation of this emerging business model (Hughes and Beukes, 2012).

The purpose of this article is to present the concept of disruption from the perspective of a Social E-Commerce company that is the leader in group buying daily deals in Puerto Rico. In the last four years, Social Media Group has obtained 80% of the market share of the group daily deal companies in the island. It achieved sales of $12.5 million in 2011 and $31.3 million in 2012. The owners are three brothers of less than 30 years old! The chief of operations is only 26 years old. This is an example of young genius entrepreneurs.

The organization of the article is as follows. The first section describes the relevant literature review of disruptive business models and identifying disruptive new businesses. The next sections are Data and Methodology, Social E-Commerce and Social Media Group. The last section includes concluding comments and recommendations according to Christensen's disruptive theory.

LITERATURE REVIEW

Disruptive Business Model

Disruptive business models introduce threats to existing ways, but also opportunities for new sources of competitive advantage (Markides, 2006). Christensen's landmark disruptive theory explains how fringe ideas come to redefine entire markets, not only explains why new businesses emerge and mature companies fall. It actually helps to predict the future success of new ventures more accurately. Raynor (2011) argues that Disruption theory is the only theory which has been statistically proven to be an effective predictive tool.

Despite the growing shelves of books offering advice on innovation, most managers continue to struggle to create the profitable growth their companies need. What is the reason? The vast majority of management theories base their prescriptions on explanations of the past. When it comes to predicting successful innovation, a willingness to apply the empirical and theoretical rigor of the scientific method to prove what will work in the real world has been notable by its absence (Raynor, 2011).

Established companies in industries as diverse as airlines, media and banking are seeing their markets invaded by new and disruptive business models. The success of invaders such as easyJet, Netflix and ING Direct in capturing market share has encouraged established corporations to respond by adopting the new business models alongside their established ones (Markides and Oyon, 2010). According to Markides and Oyon (2010) the markets that get created by new business models are not necessarily more attractive than existing markets. In addition, the new customers who are attracted to the new business models are not the kinds of customers that established corporations should necessarily pursue. For example, Internet brokerage created a huge market in the United States. Even though this market is big and growing, is it a market that all established brokers ought to go after? The answer is most probably not.

According to Markides (2006) researchers examined the theory behind disruptive technological innovation and identified a number of issues that require further and deeper exploration. The business-model innovation is one type of innovation that tends to be disruptive to established competitors. A Business-model innovation is the discovery of a fundamentally different business model in an existing business. Another type of innovation that tends to be disruptive to the established competitors is radical innovation, which creates new-to-the-world products. A radical innovation is disruptive to consumers because it introduces products and value propositions that disturb prevailing consumer habits and behaviors in a major way (Markides and Oyon, 2010). Christensen, Clayton M. (1997), in his original formulation of disruptive theory, focused primarily on technological innovation and explored how new technologies came to surpass seemingly superior technologies in a market.

Raynor (2011) suggests that all disruptive innovations stem from technological or business model advantages that can scale as disruptive businesses and move upmarket in search of more-demanding customers. These advantages are what enable the extendable core. They differentiate disruption from mere price competition.

“A disruptive innovation is an innovation that transforms the complicated, expensive services and products into things that are so simple and affordable that you and I can use them” (Christensen, 2002). According to Christensen, most of the times at the beginning of an industry, the services or the products that are available are so complicated and expensive that the only people who can participate are people with a lot of money (Richardson, 2010). Christensen (2012) explains that a disruptive technology is an innovation that transforms a product that historically was so complicated and expensive that only people with a lot of money and a lot of skill had access to owning and using it, into a product or a service that is so much more simple and affordable that a much larger population of people can now own it and use it.” It’s not a breakthrough. The meaning in Christensen’s work is simplicity and affordability. “A disruptive innovation describes a process by which a product or service initially begins as a simple application and then moves up market, eventually displacing established competitors.” “An innovation that is disruptive allows a whole new group of consumers’ access to a product or service that was originally only accessible to those who could afford it (Christensen, 2002, 2012).

The characteristics of disruptive businesses, at least in their initial stages, can include: lower gross margins, smaller target markets, and simpler products and services that may not appear as attractive as existing solutions when compared against traditional performance metrics. Because companies tend to innovate faster than their customers’ lives change, most organizations eventually end up producing products or services that are too good, too expensive, and too inconvenient for many customers. By only pursuing sustaining innovations that perpetuate what historically helped them succeed, companies unwittingly open the door to disruptive innovations (Christensen, 2002, 2012).

Identifying Disruptive New Businesses

The disruptive theory developed by Christensen (2002) indicates that most managers understand that significant, new, sustainable growth comes from creating new markets and ways of competing. But few of them make such investments in creating new markets because, first of all, when times are good and core businesses are growing robustly, starting new generations of growth ventures seems unnecessary. Secondly, when times are bad and mature businesses are under attack, investments to create new growth businesses can’t send enough profit to the bottom line quickly enough to satisfy investor pressure for a fast turnaround. The second problem is virtually insurmountable, thus, senior managers must rethink their reluctance to start new ventures in good times. After all, business units that are growing robustly today will become mature, and thus vulnerable, in the future. The only way a corporation can maintain its growth is by launching new growth businesses when the core units are strong. Christensen (2002, 2012) research indicates that “if senior managers pursue this path, and if the growth businesses they start or acquire are truly disruptive, companies will find it less difficult and risky than many have supposed to create wave after wave of new growth.”

According to Christensen’s theory, disruptive innovations appeal to customers who are unattractive to the incumbents. Although they typically involve simple adaptations of known technologies, entrants almost always beat incumbents at this game because established companies lack the motivation to win. In the day-to-day internal competition for resources and attention within large companies, projects that target large, obvious markets, invariably get priority over disruptive ones. Although every major attractive market that exists today, was at its inception small and poorly defined, just as the major growth markets of tomorrow are small and poorly defined today.

Therefore, companies that want to create new growth businesses should seek disruptive opportunities because industry leaders will not be motivated to pursue them. Christensen indicates that this approach applies to venture-backed startups, cash-rich giants and everything in between. According to Christensen’s research, the probability of creating a successful, new growth business is 10 times greater if the innovators pursue a disruptive strategy rather than a sustaining one (Christensen, 1997). Christensen suggests two general strategies for turning ideas into plans for disruptive growth businesses. The first idea requires the creation of a new market that can serve as a base for disruption; the second is based on disruption of the prevailing business model from the low end. The success of each strategy is predicated on the managers' ability to shape ideas that conform to a set of litmus tests. In creating a new market as a base for disruption companies should first search for ways to compete against nonconsumption: people's inability to use available products or services because they are too expensive or too complicated. It's much easier to target potential customers who aren't buying at all than to steal customers from an entrenched competitor. Strategies that disrupt by creating new market applications for entirely new customers should meet the following three litmus tests (Christensen 2002).

Test #1: Does the innovation target customers who in the past haven't been able to "do it themselves" for lack of money or skills? Many of the most successful disruptive growth businesses give people direct access to products or services that had been too expensive or too complex for the mainstream.

Test #2: Is the innovation aimed at customers who will welcome a simple product? If the innovation enables a new population of customers to consume for themselves, it can more easily be shaped to pass the second litmus test: The disruptive product must be technologically straightforward, targeted at customers who will be happy with a simple product. Successful disruptive innovators always target customers who welcome simple products.

Test #3: Will the innovation help customers do more easily and effectively what they are already trying to do? It is important that innovators keep in mind one essential fact: At a fundamental level, the things that people want to accomplish in their lives don't change quickly. According to Christensen, if an idea for a new growth business is predicated on customers wanting to do something that hadn't been a priority in the past, because of this stability, it stands little chance of success.

To succeed in disrupting the business model from the low end, this second strategy must meet two litmus tests. First, it must target the least-demanding tiers of a market in which prevailing products are so good they "over serve" customers. It means that there must be less demanding customers who would happily buy a good-enough product that is cheaper than those currently available. Second, the product must be made and marketed within a disruptive business model. In other words one that enables the entrant to compete profitably while pricing at deep discounts. According to Christensen, managers who shape a strategy to conform to these litmus tests can successfully create a new growth business within an existing market.

Test #1: Are prevailing products more than good enough? If available products aren't yet good enough, a disruptive innovation whose performance is even lower will not gain any traction in the market. Managers who are shaping a disruptive strategy can determine when a product's performance has overshot what customers can use, by examining rigorously market tier by market tier and the extent to which customers are willing to pay premium prices for further improvements in the functionality, reliability or convenience of a product or service. According to Christensen, if companies can sustain price increases in a given tier when they introduce an improvement in one of these areas, customers are not yet over served and that tier cannot be disrupted.

Test #2: Can you create a different business model? If the low end of a market is over served and thus, open to disruption, the second test requires managers to craft a new business model. This new business must be able to earn attractive returns at prices that can steal business at the low end. This disruptive business model consists of a cost structure, operating processes and a distribution system in which profit margins are thinner but net asset turns are higher. Thus, it creates the asymmetric motivation needed for disruptive success.

Therefore, executives who are shaping a low-end disruptive business model strategy need to be sure it is unattractive to every powerful incumbent.

The disruptive strategy needs nourishment to survive in the corporate environment. Its resources, processes and values need to be managed carefully. Managers need to determine which resources, processes and values to leverage to help the new business succeed. The counterintuitive point is that managers whom corporate leaders have learned to trust, because of their success in the mainstream business, probably cannot be counted on to lead a radical new venture. It needs a new team of managers with a disruptive thinking mind.

DATA AND METHODOLOGY

This research is qualitative. The type of study is descriptive. The technique of information gathering used was from interviews of employees and the Chief of operations.

Social e Commerce

Web 2.0 is a phenomenon that has transferred internet and the W.W.W. to a social environment, creating platforms where people can interact and create content online (Hajli, 2013). This advancement has also elevated online communities to a level where new business plans can be developed and implemented (Hajli, 2013). The emergence of Web 2.0 applications transferred human approach to the web and interconnectivity among users (Mueller et al., 2011). This interconnectivity among users created a virtual world which enables people to interact on the internet (Mueller et al., 2011). These social interactions, especially in social networking sites (SNSs), created a new stream in e-commerce. This new stream is social commerce. Social commerce is the use of Web 2.0 and social technologies to support interactions in an online context to support consumers' acquisition of services and products on the internet (Liang and Turban, 2011).

Marsden (2011) refers to social commerce as "a subset of electronic commerce that involves using social media to assist in online buying and selling of products and services." Social e-shopping refers to merging shopping and social networking activities through online social media as an application of Web 2.0 in e-commerce (Kang and Johnson, 2013). It is typified as providing online spaces in which consumers collaborate, post product recommendations and reviews, post photos of themselves wearing products, acquire advice from reliable people, seek the right products, make purchases, and form social shopping communities (Kang and Johnson, 2013). Social e-shopping and social commerce are forms of internet-based social media that enable consumers to actively participate in the marketing and selling of products and services in online communities and marketplaces (Stephen and Toubia, 2010).

The convergence of traditional and electronic business models, as well as traditional and new business practices, are changing the face of global business as we know it today. The group buying/local daily deals e-commerce platform represents the collective bargaining power that individuals can leverage to obtain daily deals on local products, services and "experiences" (Hughes and Beukes, 2012). These local discounted deals are distributed via e-mail and the websites of companies like Groupon and LivingSocial that have established themselves as the sector leaders. In Puerto Rico, the leader in this sector is Gustazos, a subsidiary of Social Media Group.

Social E commerce "is a 'disruptive' innovation that is radically changing the traditional way of doing business" (Lee, 2001, p. 349). It has changed the nature of the value propositions that companies now offer to their customers. The convergence of content sites and social networks has resulted in emerging social e-commerce business models (Hughes and Beukes, 2012). Social E-commerce is growing at five times the rate of traditional retail channels. New avenues of e-commerce, such as daily deals offered by companies like Groupon and LivingSocial, have boosted the sector's momentum since 2010 (Gridley and Company, 2011, p. 6). The group buying industry has an estimated value of approximately $2.7 billion (Kessler, 2011). This translates into roughly 138% growth in 2011 alone (Kessler, 2011).

Groupon has taken the established and unquestioned marketing tactic of utilizing discount coupons and brought it swiftly into the 21st century (Hughes and Beukes, 2012). LivingSocial has brought social interaction and life experiences online. In addition, these new technology platforms provide local businesses with access to their closest customers. Customers become co-creators of value. The emergence of daily deal social group buying sites challenges our traditional understanding of what it takes to build a business that is profitable. It is interesting from both a strategy perspective, as well as a development and growth perspective (Hughes and Beukes, 2012).

According to Hughes and Beukes (2012) the term social e-commerce was coined in 2008 when companies, like Facebook, started to receive massive capital injections. Soon, other companies start to emerge when they realized the massive potential buying power of online social groups, thus they focused on capitalizing on this phenomenon. LivingSocial was one of the first companies of this nature to arise. LivingSocial (originally known as Hungry Machine; trading as Living Social since 2009) was launched in 2007 as a group buying social commerce site (CrunchBase, 2011). It offers customers "handpicked experiences that can be shared with friends" (LivingSocial.com, 2011).

In December 2010, LivingSocial secured $175 million investment from Amazon and an additional $8 million investment from Lightspeed Venture Partners (LivingSocial.com, 2012). More than 60 million users and their acquaintances can save as much as 90 percent per day on everything from restaurant meals to hotels and sporting events (CrunchBase, 2011; LivingSocial, 2012; Gridley and Company, 2011).

Groupon, the fastest growing and biggest daily deal social group buying site and LivingSocial's biggest competitor, was launched in November 2008. It features a daily deal on "the best stuff to do, see and buy in more than 500 markets and 44 countries" (Groupon, 2011). Within a year, Groupon had one million adherents and today it has 143 million subscribers around the world (Anonymous, 2011). In the first 18 months it went from zero to $500 million in sales.

Social Media Group

Social Media Group (SMG) is a social media company established in 2009 by the Villares brothers in Puerto Rico. SMG is the parent company of Gustazos, the group daily deals leading company in the island with 80% of the market share in that category and 738,401 Facebook Fans (as of October, 2013). Gustazos, as a group daily deals company sells any kind of discount coupons, from hotels to Spas, restaurants, adventure tours, etc. The company has 80 employees in Puerto Rico. The organizational environment of Gustazos is open, relaxed and young. The age of its employees fluctuates between 25 and 35 years old. In addition, Gustazos has offices in Jamaica, Tenerife (Canary Islands), Dominican Republic and Canada.

According to the Royal Academy of the Spanish Language Dictionary, "Gustazo" means great pleasure that someone gives himself doing something unusual, or even harmful, thus satisfying an aspiration, his own pride, or a desire for revenge. The basic idea behind Gustazos business is nothing new. The consumers sign up to receive offers from local firms by e-mail each day. The offers range from restaurant meals to dancing lessons, at discounts of up to 90%. What makes Gustazos really stand out, however, are its margins. Gustazos typically charges businesses half of the discounted price of a voucher. This goes a long way towards explaining why the start-up was able to raise $6 million in 2010, $12.5 million in 2011, and $25 million in 2012.

In the group daily deals sector competition is fierce. Almost anyone can set up a daily-deals site. There are hundreds of clones in the United States of America alone, most specializing in certain product categories.

To help overwhelmed consumers, there is even a service, The Dealmap, which lists all the daily deals available in a city. Big online firms have begun to enter the fray. In December, 2010, Amazon invested $175 million in LivingSocial, the market's number two, which is said to be in talks to raise a further $500 million. In addition, Facebook, the world's biggest social network, will soon start testing local discounts (Anonymous, 2011).

Gustazos target market is high-end businesses, five star hotels, restaurants, spas, etc. In order to improve its efficiency in the hotel services, Gustazos decided to create Guestserve. This is an independent division that manages everything regarding hotel reservations and payments, once the members buy a hotel coupon. In addition, Gustazos has SI3D, Search in 3D, a digital engineering division in charge of design. A new division still in development is 360 hang out. This new division records live concerts with special cameras, getting a 360 view of the place. This is going to be a smartphone application.

Another microbusiness division is called Merodea.me. This division is dedicated to sell fashion design clothing and accessories from designers of Puerto Rico at great discounts. It works by invitation. Members need to register and get invited to be members, and then they are allowed to buy. JoinaJoin is a vacation rental microbusiness division. Anybody that has a vacation property that wants to rent for short time periods use JoinaJoin services. Hidden and secret places are spotted in JoinaJoin.

All of these divisions even though they work independently, use Gustazos resources and membership. In exchange they share profits with Gustazos according to their contracts. In addition, they take advantage of the dynamic organizational culture of this company. The most valuable asset is the people that work in there. They have passion for what they are doing; all are young and have a sense of responsibility and commitment in their jobs. The company is the leader in this market because the owners know the idiosyncrasy of the Puerto Rican culture. Gustazos is disrupting the market with new ideas. All employees are welcome to bring wildest ideas to break the paradigms of social businesses.

Gustazos' mission statement is "Help and encourage people to experience the best life has to offer. "Gustazos offers to its business clients, "an efficient and cost effective way of obtaining what you've always wanted from publicity: new clients!" (This is the slogan written in their web page). The competitors of Gustazos in Puerto Rico are: Oferta del Día (from El Nuevo Día newspaper), Pero Qué Descuentos, Groupon, Cuponeando, Yupiti, Kiero Kiero, Shop PR and GrooPanda. All these competitors are fighting the 20% market share left by Gustazos.

CONCLUDING COMMENTS

The purpose of this article is to present the concept of disruption from the perspective of Social Media Group and its subsidiary Gustazos. This is a qualitative research case study. The information gathered was from interviews of employees and Gustazos' Chief of Operations. Gustazos has disrupted the market of the group buying daily deals in Puerto Rico. It is a sound example of a disrupted business model.

Gustazos is a social commerce company that is the leader in group buying daily deals in Puerto Rico. Its strategies of disrupting the market with new divisions, new technology and developing new markets, have made them the leader in group daily deals in Puerto Rico, capturing 80% of the market in only 4 years. Gustazos created a new market and broke the paradigm of group buying daily deals. Christensen (1997) pointed out that the new markets created by the invading disruptive business model are different from the established market. In the disruptive business theory the most important rule is to adopt a strategy that breaks the rules of the game in that market. This generalization has been supported by many high-profile examples, including Canon's success in entering the copier market, IKEA's entry in the furniture retail business, Southwest's entry in the airline market and Enterprise's entry in the car rental market (Markides and Oyon, 2010).

Gustazos success in entering the new market is because it developed a different business model that makes it simple and affordable the products and services that they are offering. Established companies that succeed in entering the new markets do so by developing radically different business models, different from the one that the disrupters are using and different from the one it employs in its established market. They follow the same logic that disrupters used to attack them. The disrupters companies succeeded in attacking the main market because they used a disruptive business model. If the established corporations want to have the same success, they also need to utilize a disruptive business model to enter the market that the disruptive business model has created. In a sense, they need to "disrupt the disrupter," as Nintendo did in response to Sony and Microsoft in the video games console market. Instead of targeting teenagers and young men as Sony and Microsoft did, Nintendo developed the Wii specifically to target families. Instead of emphasizing functionality, speed and superior graphics (as the PlayStation and Xbox did), the Wii stressed ease of use and simplicity.

The limitations of the study are lack of literature on this topic and lack of knowledge regarding other companies with a disruptive business model. There are very few studies of disruptive businesses. In addition, companies are reluctant to give information about their strategies and organizational environment due to competition "copycats." This was the case of Gustazos. Further research could answer questions such as what is the impact of disruptive business models on solving social problems. How many cases like Social Media Group exist in Puerto Rico? What can we learn from them?

RECOMMENDATIONS ACCORDING TO CHRISTENSEN'S DISRUPTIVE THEORY

In an increasingly volatile world it is imperative to develop a disruption of your own before it's too late to reap the rewards of participation in new, high-growth markets--as Procter & Gamble did with Swiffer, Dow Corning with Xiameter, and Apple with the iPod, iTunes, the iPad, and (most spectacularly) the iPhone (Wessel and Christensen, 2012).

Companies need to create different processes for evaluating and shaping disruptive ideas (Christensen, 2002). The process starts with training. In most companies, the sales, marketing and engineering employees have the great ideas. Employees at all levels should be trained in the language of sustaining and disruptive innovation and understand the litmus tests so that they know what kinds of ideas they should channel into sustaining processes and what kinds they should direct into disruptive channels.

Capturing ideas for new growth businesses from people in direct contact with markets and technologies is far more productive than relying on analyst-laden business-development departments. Front-line employees are also well positioned to scout for small acquisitions with disruptive potential. Christensen recommends, if the price is reasonable, it is often better to acquire a company whose strategy passes the litmus tests than to start from scratch internally. Creating processes for shaping disruptive business plans ideas with disruptive potential need a destination. Therefore, senior management should create a team at the corporate level that is responsible for collecting disruptive-innovation ideas and molding them into propositions that fit the litmus tests. The members of this team have to understand the litmus tests at a deep level and use them repeatedly. Such experience will help the team develop a collective intuition about how to shape disruptive business plans (Christensen, 2002).

The process for selecting managers needs to employ very different criteria from those used to promote managers within established businesses. The team should coach each new venture's management on techniques like discovery-driven planning that can speed the emergence of a winning strategy (Christensen, 2002). This team must also be the visible and vocal advocate of new growth businesses. (In Gustazos' case management is seriously committed to this principle). Christensen recommends that twice a year or so, team members should hold refresher training sessions with sales, marketing and engineering personnel in each operating unit, in order to provide updates on how previous ideas had been shaped into plans for high-potential growth businesses, and to describe why other ideas could not pass the litmus tests.

Processes are defined only when a group of people does something over and over again. These processes for creating disruptive growth businesses need to be honed in a dedicated group. Christensen proposes that starting successful growth businesses isn't as random and failure-fraught as it has appeared. It is complicated, to be sure, but it only appears random, because managers haven't understood the factors that lead to success or cause failure. Spending too much on the wrong strategy in an attempt to get big fast; putting people with inappropriate experience in charge; violating the litmus tests; and launching growth initiatives in an ad hoc manner when it is already too late; are reasons for failure that can be managed and avoided. The executives who understand the potential pitfalls and work to make the creation of disruptive new businesses a corporate process, an organizational capability that is constantly practiced, can start laying the groundwork for a company future blessed by continuous healthy growth (Christensen, 1997, 2002, 2012).

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