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The Effects of Employee Recognition, Pay, and Benefits on Job Satisfaction: Cross Country Evidence

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Abstract: This paper analyzes the effect of employee recognition, pay, and benefits on job satisfaction. In this cross-sectional study, survey responses from university students in the U.S. (n = 457), Malaysia (n = 347) and Vietnam (n = 391) were analyzed. Employee recognition, pay, and benefits were found to have a significant impact on job satisfaction, regardless of home country income level (high, middle or low income) and culture (collectivist or individualist). However, the effect of benefits on job satisfaction was significantly more important for U.S. respondents than for respondents from Malaysia and Vietnam. The authors conclude that both financial and nonfinancial rewards have a role in influencing job satisfaction, which ultimately impacts employee performance. Theoretical and practical implications for developing effective recruitment and retention policies for employees are also discussed.

Key words: HR practices; employee recognition; pay; benefits; job satisfaction; culture; Vietnam; Malaysia; USA

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1. Introduction

No resource is more critical to an organization's success than its human resources are (DeNisi & Griffin, 2008, p. 5); people are the only strategic weapon a company has that cannot be copied by its competition (DeCenzo & Robbins, 2010, p. 4). Employees who are competent, motivated and satisfied lead to more productive organizations overall (Baron & Kreps, 1999; Caligiuri, Lepak, & Bonache, 2010; Pfeffer, 1994). Satisfied employees are more likely to be committed to their organizations and exhibit higher levels of performance and productivity (e.g., Steinhaus & Perry, 1996; Cranny, Smith, & Stone, 1992; Weiss, 2002). Employee's job satisfaction offers important clues concerning the health and performance of an organization and provides information on where improvements can be made to the organization.

Considerable research has been conducted to assess the impact of different types of rewards on job satisfaction. While pay and benefits are common financial incentives, employee recognition, can be derived from both financial and nonfinancial rewards (DeCenzo & Robbins, 2010). Yet, previous research has given little

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attention to employee recognition as a factor that affects job satisfaction. Further, the majority of job satisfaction studies have been conducted in across different occupations in one organization or across multiple organizations in one country, typically in the West, with researchers pointing to the need for future research to examine job satisfaction across different cultural contexts. The main goal of the current study is therefore to assess the effects of three job rewards (recognition, pay, and benefits) on job satisfaction in three countries (U.S., Vietnam and Malaysia) having different cultures and levels of economic development (GNI).

2. Literature Review

Employee's job satisfaction is a well-researched topic across several disciplines including organizational behavior, HR management, industrial-organizational psychology, and social psychology (Cranny et al., 1992; Darling, Arn, & Gatlin, 1997; Hoppock, 1935; Ramayah & Nasurdin, 2006; Weiss, 2002). The widespread interest in job satisfaction can be explained by the fact that it affects most individuals due to the substantial part of their lives spent at work. Understanding the factors that influence job satisfaction can potentially lead to improving employee and organizational performance.

Job satisfaction has been defined in a number of ways by various scholars (e.g., Hoppock, 1935, p. 38; Locke, 1976, p. 1300; Robbins & Judge, 2008, p. 83). The central theme is similar across studies, a positive feeling of one's job resulting from an evaluation of its characteristics. Job satisfaction has been studied both as an independent and a dependent variable. As an *independent variable*, job satisfaction explains outcomes such as performance, absenteeism, and turnover (e.g., Podsakoff & Williams, 1986; Cranny et al., 1992; Hoppock, 1935; Smith, Kendall, & Hulin, 1969; Spector, 1985; Ramayah & Nasurdin, 2006). For example, job satisfaction leads to reduced turnover. In this study, we examine job satisfaction as a *dependent variable* affected by a number of rewards, including pay, benefits, and employee recognition. Previous studies have demonstrated that employee recognition/rewards lead to higher job satisfaction (e.g., Nelson, 2005; Darling et al., 1997; Rathi & Rastogi, 2008). To explain this relationship, we developed the model depicted in Figure 1 showing the impact of rewards on job satisfaction. We test this relationship empirically with three samples drawn from the U.S., Malaysia, and Vietnam. In the model, rewards are comprised of job rewards that include recognition, pay, and benefits packages. It must be noted that, under the literature review, we stressed more on employee recognition for it has received little attention in the literature on job satisfaction as compared to pay and benefits.

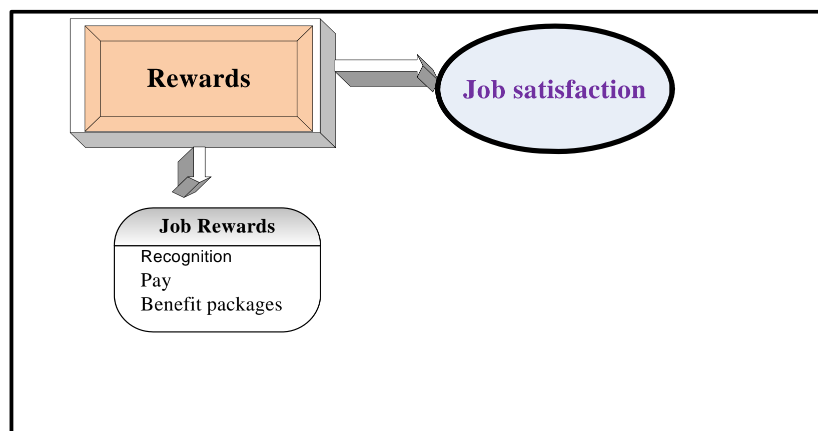

Figure 1 Factors Affecting Job Satisfaction

2.1 Employee Recognition and Job Satisfaction

Research shows that both financial and nonfinancial rewards impact the job satisfaction and motivation of employees (DeCenzo & Robbins, 2010; Haile, 2009; Severinsson & Hummelvoll, 2001). Employees are likely to be motivated to improve their performance with nonmonetary rewards such as employee recognition. Recognition is the acknowledgement, appreciation, or approval of the positive accomplishments or behaviors of an individual or team (Caligiuri et al., 2010; Nelson, 2005; University of Iowa, 2009). According to Gostick and Elton (2007), recognition refers to praise or a personal note acknowledging achievements including small gestures that are important to employees.

2.2 Why Should We Recognize Employees?

One valuable outcome and reason for recognizing employees is that studies show that people who feel appreciated are more positive about themselves and their ability to contribute, i.e., employee recognition can boost productivity and increase satisfaction (Daniels, 1999; Darling et al., 1997; Nelson, 2005; Gostick & Elton, 2007). A number of research studies indicate that nonfinancial rewards such as recognition and other intrinsic rewards are *sine qua non* for job satisfaction (Darling et al., 1997; Nelson, 2005). Based on a survey of 200,000 employees, Gostick and Elton (2007) conclude that if employee recognition is conducted properly, it can increase profitability and customer service levels, and heighten employee engagement and satisfaction. Nelson (2005) concludes that recognition leads to improved communication (employees are more likely to offer solutions and new ideas), better cooperation (employees are more likely to offer to help and go the "extra mile"), and decreased absenteeism and turnover (employees will demonstrate higher job satisfaction and loyalty). Daniels (1999) concludes that quality and productivity are enhanced when supervisors simply increased their daily frequency of contingent positive reinforcement. Employees benefits from positive reinforcement and recognition from peers and/or management. Recognition can motivate, helping to build feelings of confidence and satisfaction (Keller, 1999) and inspire loyalty and commitment, as well as encouraging employees to extend their efforts (Robbins & Judge, 2008). Darling et al., (1997) argues that one of the most effective morale boosters is praise for a job well done. She further surmises that regularly recognizing and rewarding employees can be one of the easiest ways to keep employees satisfied and productive. For many individuals, feelings of self-worth are directly associated with their work.

Recognition is an important tool for managers, business owners and HR professionals in promoting employee motivation and organizational success. Allen and Helms' (2002) research confirmed the importance of regular expressions of appreciation by managers and leaders to encourage behavior of employees to reach strategic goals. Despite the important role of recognition in motivating employees, only about 40 percent of North American workers say they receive recognition for a job well done or get recognized for outstanding individual performance. All too often, simple nonmonetary types of rewards are overlooked and underutilized by managers (Kouzes & Posner, 2003). In one study, only about 50 percent of managers say they provide recognition for high-performance (Kepner-Tregoe quoted by Kouzes & Posner, 2003). While recognition is not widespread, Nelson's (2005) study shows that 78 percent of employees indicate that it is very important for them to be recognized by their manager, and 84 percent of managers concluded that providing nonmonetary recognition as a reward has increased performance. Further, 91 percent of managers conclude that recognizing employees helps motivate them.

2.3 How Can We Recognize Employees?

There are many ways employees can be recognized or appreciated. Recognition can include letters or postcards ("Thanks! You Made A Difference" Award), memory items (a plaque or mug) that last longer than cash,

nonmonetary awards that have trophy value, lunch with managers/supervisors, a picture displayed in a prominent place, having a room or hallway named after the employee, posting names (employee of the week or month) in the organization's notice board or website, a video rental certificate, a coffee card, an event ticket, or a candy bar (Darling et al., 1997; Nelson, 2005; University of Iowa, 2009).

Recognition ranks as one of the most powerful motivators and plays a key role in effective reward practices (Childs, 2005). These informal rewards require minimal planning, efforts or expense (Darling et al., 1997; Gostick and Elton, 2007) and can be given for a number of reasons including recognition for a job well done, a birthday, a service anniversary, a special favor, completing an unpleasant task, or saving the company time or money (Darling et al., 1997). Effective recognition measures can also include verbal and written praise, public praise, and symbolic gestures by managers (Nelson & Spritzer, 2002). Recognition efforts that are timely, sincere, and personal can serve as a major means of motivation to employees.

Nelson and Spitzer (2003) state that managers need to be in constant contact with the employees if they are to determine what they most value and then find ways to act systematically on those desired forms of recognition and rewards as they perform well. This suggests that managers need to vary the forms of recognition, adding new things, experimenting with them, and eliminating others that have run their course and are no longer motivating to employees. If managers are timely, sincere, and specific in thanking employees when they have done good work, it will maintain credibility in the recognition process.

2.4 What Should We Consider When Recognizing Employees?

If recognition is to provide the desired results, organizations need to commit the required attention and time. Managers need to create goals and action plans that recognize the behaviors and accomplishments that warrant rewards within the organization (Caligiuri et al., 2010; Sartain & Finney, 2003). Managers should establish criteria for identifying employees who are eligible for recognition, then recognize anyone who meets the criteria by being consistently fair. Recognition programs have to be tied to achievement and business related activities (Caligiuri et al., 2010; Nelson, 2005). Managers need to be specific and timely when providing recognition, which will help create positive feelings that will affect employee performance (Darling et al., 1997; Daniels, 1999). According to Gostick and Elton (2007), if employee recognition is to provide favorable outcomes, it needs to be applied within a context of goal-setting, open communication, trust and accountability. A good recognition program has to communicate attitudes and behaviors that are recognized by the organization. According to the University of Iowa (2009), if recognition is to provide the required results, it needs to have personal value, requiring managers to consider the nature of the accomplishment and the recipient's preferences; it must be earned, requiring managers to focus on the nature of the accomplishment the recipients view as meaningful; it must be timely, requiring managers to reward immediately; and it has to be accompanied by a celebration, requiring managers to get to know the individual before planning the delivery forum-whether public or delivered one-on-one. Finally, the attitude of celebration is a key factor in creating a lasting, positive memory of the recognition effort.

By personalizing rewards, an organization communicates the extent to which it values and cares for its employees. A sincere word of thanks from the right person at the right time can mean more to an employee by providing recognition of their value than a pay raise (Darling et al., 1997; Rathi & Rastogi, 2008). Employees need to be shown that their achievements have been recognized and appreciated. Recognition of employee performance may take two forms: team and individual. The best recognition singles individuals or groups out for extraordinary performance. It is based upon those areas that make the biggest difference to the individual or group's mutual success. Employees have different values, attitudes, interests and expectations that must be

considered when deciding on the optimal recognition method. One type of recognition may not motivate everyone in the same way. Recognition programs need to respond to individuals' expectations, which require proper planning and implementation.

While recognition is important, an organization should not recognize everyone consistently. Recognition must have value. According to Nelson & Spitzer (2003), leaving employees out does not tend to be a problem in organizations that have developed a strong recognition culture, that have a variety of formal and informal programs and tools, and where managers place an emphasis on daily recognition practices and behaviors. However, it could be argued that if a recognition program is used incorrectly, it can depress, not lift, employee morale. When a manager uses recognition program to motivate an employee—whether a fast tracker or an underachiever—the goal is to reinforce successful behaviors so the employee will repeat them and apply the same determination to other tasks (Darling et al., 1997; Daniels, 1999; Nelson, 2004). Based on the above discussions, we hypothesize that:

Hypothesis 1a: Employee recognition significantly affects job satisfaction.

2.5 Economic Development and Employee Recognition

The World Bank (2009) classifies economies using gross national income (GNI) per capita (previously referred to as gross national product, or GNP). Based on its GNI per capita, every economy is classified as either low income ($995 or less); lower middle income ($996-$3,945); upper middle income ($3,946-$12,195); or high income ($12,196 or more). The three countries in this study fall into three different income categories; high-income (the U.S. with a GNI per capita of $47,240), upper middle-income (Malaysia with a GNI per capita of $7,230), and lower middle-income (Vietnam with a GNI per capita of $1,010). Recognition is generally good for business, no matter where the business is located (Nelson, 2005). Regardless of the economic development of countries, all employees are likely to value recognition. From this, we hypothesize the following:

Hypothesis 1b: Despite differences in levels of economic development, students from the three sample countries (America, Malaysia and Vietnam) will feel that recognition is important to their job satisfaction.

2.6 Pay and Job Satisfaction

Previous studies have demonstrated that pay affects job satisfaction (Caligiuri et al, 2010; Cranny et al., 1992; Islam & Ismail, 2004; Steinhaus & Perry, 1996; Weiss, 2002). Employees expect a certain level of monetary rewards for their organizational contribution, and pay constitutes a quantitative measure of an employee's worth. In order to compete for the most talented workers, companies need to provide attractive and equitable pay. It has been argued that pay is a motivator for many employees initially, but it is not a powerful motivator over the long term. The role of pay in attracting and retaining people at work has been recognized for many decades and is increasingly important in today's competitive, economic environment where strategic compensation planning is needed (Jackson & Schuler, 2006). Based on the previous studies, we propose the following hypothesis:

Hypothesis 2: Pay positively affects job satisfaction.

2.7 Benefits Packages and Job Satisfaction

Currently, especially in the developed world, employee benefits packages have become an important part of the total compensation or organizational expenses. Employee benefits average 40% of the total compensation package (DeCenzo & Robbins, 2010). Benefits have grown in size, importance and variety (DeCenzo & Robbins, 2010; Edgar & Geare, 2005; Milkovich & Newman, 2008), and the U.S. Chamber of commerce, concludes that employee benefits are one of the greatest challenges in business today in attracting and retaining quality employees (U.S. Chamber of Commerce, 2008). This growth suggests that employees increasingly value employee benefits as

part of their overall compensation package. As a result, the following hypothesis was formulated:

Hypothesis 3: Employee benefits packages significantly affect job satisfaction.

3. Culture and Rewards

As international business increases, differences in values and beliefs create some challenges for managers of multinational companies. Culture is undoubtedly one of the most important factors affecting rewards management. Theorists suggest that the individualism-collectivism dimension identified by Hofstede (1980) may indeed represent the most important dimension of cultural variability (DeCenzo & Robbins, 2010; Triandis, 1995). Culture influences most HR policies and practices including rewards (Dowling, Festing, & Engle, 2009). Organizations will continue to grapple with questions such as: Should rewards be based on performance or seniority? Should rewards be group based or individual based? What would be the mix of financial and nonfinancial rewards? The answers to the above questions are influenced by organizational and national culture. While American workers generally desire rewards (e.g., pay increases) based on individual performance based on an individualistic society, Asian workers generally desire rewards based on seniority or group-based rewards common to a collectivistic society (Dowling et al., 2009). In addition, studies show that Americans generally want compensation to be mainly variable and less fixed (supporting a risk taking orientation), as compared to Asians who want to have more fixed and less variable compensation (supporting a risk averse orientation) (Dowling et al., 2009; DeNisi & Griffin, 2008; Hofstede, 1980; Triandis 1995). This suggests that rewards administration should reflect national and organizational cultures. Employees of different countries vary in attitudes and perceptions of the reward process. However, one can argue that regardless of the effect of culture on reward management, employees from different cultural backgrounds are likely to believe both financial and nonfinancial rewards are important to job satisfaction. Based on the above arguments, we propose the following three hypotheses:

Hypothesis 4a: Despite differences in cultural orientation (collectivism/individualism), respondents from the three sample countries (America, Malaysia and Vietnam) will feel that pay is important to their job satisfaction.

Hypothesis 4b: Despite differences in cultural orientation (collectivism/individualism), respondents from the three sample countries (America, Malaysia and Vietnam) will feel that employees benefits packages are important to their job satisfaction.

Hypothesis 4c: Despite differences in cultural orientation (collectivism/individualism), respondents from the three sample countries (America, Malaysia and Vietnam) will feel that recognition is important to their job satisfaction.

4. Methodology

4.1 Measures

A wide variety of disciplines have examined the issue of job satisfaction, with data typically being collected from self-report surveys. The most common way of measuring job satisfaction is the use of rating scales where employees report reactions to their jobs. In measuring satisfaction with the three types of job rewards included in the model (pay, benefits, and recognition), we used the modified version of the scale by Spector (1985). For example, "Being paid fairly for the work that I do is important to my satisfaction on the job"; "Having a good benefits package is important to my satisfaction on the job"; "Receiving recognition for doing a good job is important to my satisfaction in the job". In measuring the overall job satisfaction, we used the Job in General (JIG)

scale (Smith, Kendall, & Hulin (1969), which is a measure of global satisfaction with one's job. For example, "Overall, I am satisfied with my job".

Responses were based on a 7-point Likert-type scale, ranging from strongly disagree (1) to strongly agree (7) as shown in Table 2. In addition, each respondent was asked to provide selected background information, including university standing, major, gender, and work experience, as shown in Table 1. Except for the variables "university standing" and "major", which are simply entered in the equation as continuous variables, "gender" and "work experience" are measured as dummy variables.

4.2 Sampling Technique

In this study, a questionnaire survey was administered to university students enrolled in U.S., Malaysia, and Vietnamese universities. Three samples were used to test the proposed hypotheses. The first sample consisted of 457 students from a Midwestern university in the U.S. The second sample included 391 students from a national university in Vietnam. Finally, the third sample consisted of 347 students from a national university in Malaysia.

5. Results

Table 1 reports selected profile or background information of the three samples (U.S., Vietnam, and Malaysia). The majority of the respondents from each of the countries were junior and senior business majors.

Table 1 Selected Profile of the Three Samples

Variables		US		Vietnam		Malaysia	
		(n = 457)	100%	(n = 391)	100%	(n = 347)	100%
Major	Management	144	31.6	84	21.4	102	29.4
	Business Adm.	87	19.1	142	36.2	119	34.3
	Marketing	70	15.3	18	4.6	9	2.6
	Accounting	39	9.5	28	7.2	14	4.0
	Finance	33	7.2	6	1.6	16	4.6
	Others	84	18.3	113	29	93	26.8
University standing	Freshman	0	0	0	0	35	10.1
	Sophomore	3	0.7	0	0	82	23.6
	Junior	146	32.0	165	42.3	39	11.0
	Senior	308	67.4	226	57.7	191	55.1
Gender	M	230	50.6	204	52.1	200	57.8
	F	227	49.4	187	47.9	147	42.2
Do you have work experience?	Yes	429	93.9	167	42.6	230	66.8
	No	28	6.1	224	57.4	115	33.2

Table 2 shows descriptive statistics including means, and standard deviations for the three samples and ANOVA-test results. According to the analysis in Table 2, the overwhelming majority of the variables were rated between 4.9 and 6.3 on a 7-point scale. The results demonstrate that pay, benefits packages and recognition are important to students' job satisfaction in all three countries. To determine if differences in perceptions exist across these three countries, an ANOVA test was conducted.

Table 2 Descriptive Statistics and Results of ANOVA F-Tests

variable	Economy/GNI												Culture								
	High income (USA)			Middle income (Malaysia)			Low income (Vietnam)			ANOVA test			Individualist society (USA)			Collectivist society (Malaysia & Vietnam)			ANOVA test		
	M[*]	SD	n	M[*]	SD	n	M[*]	SD	n	*df*	*F*	*Sig.*	M[*]	SD	n	M[*]	SD	N	*df*	*F*	*Sig.*
Pay	6.3	0.8	457	6.1	0.9	346	6.2	0.9	391	(2,1194)	2.3	NS[**]	6.3	0.8	457	6.2	0.9	734	(1,1191)	2.4	NS[**]
Benefit packages	6.2	0.91	455	5.8	1.2	346	5.9	1.1	390	(2,1191)	15.7	0.000	6.2	0.9	455	5.8	1.2	736	(1,1191)	29.3	0.000
Recognition	5.8	1.1	455	5.8	1.1	346	5.7	1.0	390	(2,1191)	0.08	NS[**]	5.8	1.1	455	5.8	1.0	735	(1,1190)	0.03	NS[**]
Overall job satisfaction	5.2	0.90	456	5.0	1.0	347	4.9	1.1	390	(2,1193)	9.4	0.007	5.2	0.9	456	4.9	5.0	736	(1,1192)	8.8	0.003

Table 2 shows that while all groups agree that pay, benefits package and recognition are important to job satisfaction, statistically significant differences exist between two of the four variables (benefits package and overall job satisfaction). The results support Hypothesis 4a in that pay is important to respondent's job satisfaction in all three countries, despite differences in cultural orientation. However, the findings show statistically significant differences in perceptions regarding the importance of benefits packages to job satisfaction ($F (2, 1191) = 15.7$, $p < 0.001$). A closer examination of the means reveals that U.S. students exhibit a significantly higher agreement ($M = 6.2$, $SD = .91$) in their belief that benefits packages are important to job satisfaction than the Vietnamese ($M = 5.9$, $SD = 1.1$) or Malaysian students ($M = 5.8$, $SD = 1.2$). Hence, Hypothesis 4b is supported although significant differences are found in the level of support. U.S. students feel that benefits are more important in their job satisfaction than do the Vietnamese or Malaysian students. In addition, results in Table 2 support Hypothesis 4c that recognition is important to respondent's job satisfaction. The result may suggest that regardless of their culture, all respondent groups have similar perceptions about the importance of employee recognition to their job satisfaction. Finally, while all respondent groups indicate they are satisfied with their job, U.S. students were found to have significantly higher levels of satisfaction.

Next, regression analysis was conducted to examine the impact of pay, benefits packages and recognition on job satisfaction. We would expect that all three variables would positively impact job satisfaction. Table 3 shows this expected relationship. All three variables significantly impact job satisfaction with pay providing the largest level of support, followed by benefits and then recognition. Hence, the regression Model 1 supports Hypotheses 1, 2, and 3.

Table 3 Results of Regression Analyses on Job Satisfaction [a]

Variables	Model 1	Model 2
Pay	0.40[***]	0.40[***]
Benefits package	0.30[***]	0.29[***]
Recognition	0.25[***]	0.25[***]
Gender		-0.02
Country (GNI)		0.08
Culture		0.09
Work experience		0.04
R	0.73	0.74
R^2	0.54	0.55
R^2 change		0.03
F change	458[**]	2.9

Note: [a] Standardized regression coefficients are reported; [***] $p < 0.001$; N = 1195.

In Model 2, in Table 3, when gender, country (GNI), culture (individualistic/collectivistic) and work experience were added, the impact on R^2 was only .03, which is not statistically significant. The results show that none of the above-mentioned control variables was found to influence job satisfaction significantly. This further implies that the three proposed rewards are among the main predictors of job satisfaction (e.g. Nelson & Spitzer, 2003; Gostick & Elton, 2007; Sartain & Finney, 2003) and are consistently important to job satisfaction in Western and non-Western countries and across differing levels of GNI.

6. Discussion

One of the goals of the current study was to assess the relative impact of three types of rewards on job satisfaction. To that end, we performed a regression analysis as shown in Table 3. Our analysis provides support for three important findings. First, as posited, pay, recognition and benefits were found to affect students' job satisfaction positively. Second, these three variables show a statistically significant positive impact in explaining the change in students' job satisfaction and are greater than or equal to ß = 0.25. Third, the three variables altogether explain about 54 percent of the variance in students' job satisfaction ($R^2 = 0.54$). These findings are consistent with the predicted relationships and provide support to our proposed model. This suggests that the more the suggested rewards are in place, the more satisfied are the employees, which according to previous research will favorably impact employee and organizational productivity (Daniels, 1999; Nelson, 2005).

An interesting finding of this study is that respondents across all three countries are not only satisfied at work and motivated by monetary rewards such as pay and benefits packages, but are also motivated by nonmonetary rewards such as recognition, an area often overlooked by managers (Darling et. al., 1997). This finding encourages organizations to develop a comprehensive strategy that involves both financial and nonfinancial rewards that take into account both organizational and national cultures (Armstrong, 2009; Dowling et al., 2009) considering that each reward motivates employees differently. If employees feel that they are not valued for their contributions or rewarded, their commitment may be threatened (Nelson, 2005).

Table 2 shows that respondents from the three sample countries believe that benefits packages are important to their job satisfaction. However, the U.S. students felt that benefits packages are more important than the Malaysians or Vietnamese students. One possible explanation is the rising cost of benefits in the U.S., which makes benefits packages an important part of the overall compensation package. At present, the cost of benefits (including health care cost) consists of 40 percent of the total compensation package (DeCenzo & Robbins, 2010; Milkovich & Newman, 2008; Robbins & Judge, 2008). This may suggest that, if managers are to attract, hire, motivate and retain the best and brightest employees, they need to understand what employees need and expect from their employers regarding total compensation packages. Recognition is important to job satisfaction, regardless of employees' culture or country's level of economic development (GNI). However, this does not mean that culture (individualist/collectivist) of the respondents does not affect the way rewards such as pay and employee recognition programs are managed (Dowling et al., 2009; Tayeb, 2005). It could be argued that although rewards (e.g., pay and recognition) affect job satisfaction, the way they are implemented should reflect organizational and national culture; in short, local adaptation is needed. According to Darling et al. (1997), rewards should be adjusted according to what the given culture values. To be effective, a recognition program must be part of a culture of valuing employees (Darling et al., 1997).

The respondents in the U.S. sample reported significantly higher overall job satisfaction than did the

Vietnamese and Malaysian samples, and significantly higher importance in benefits on overall job satisfaction. One possible explanation is the way employees are managed—compensated, treated and supervised (Harris, 2009; Robbins & Judge, 2008). This may be due to the introduction of the progressive HRM and the government laws that affect HRM in the US (e.g., Social Security Act of 1935; Fair Labor Standards Act [FLSA] of 1938, Equal Pay Act of 1963, Civil Rights Act of 1964; Employee Retirement Income Security Act [ERISA] of 1974; the Privacy Act of 1974; Consolidated Omnibus Budget Reconciliation Act 1985 [*COBRA]*; the Worker Adjustment and Retraining Notification Act of 1988; the Family and Medical Leave Act of 1993; Health Insurance Portability and Accountability Act 1996 [*HIPAA]*). The above laws were introduced to protect and promote employees' economic and social wellbeing. Research shows that over the past 30 years, the majority of U.S. workers have been satisfied with their jobs, although they indicate less satisfaction with their pay and promotional opportunities recently (Harris, 2009; Robbins & Judge, 2008). Robbins & Judge (2008) concluded that there has been a decline in job satisfaction since the early 1990s—nearly an eight percent drop in the United States alone during what has been labeled a period of economic expansion. Plausible explanations for this decline in job satisfaction may be heavier workloads that have resulted in increased productivity, tighter deadlines and the general feeling by employees that they have less control over their work. Robbins & Judge (2008) argue that while some segments of the market are more satisfied than others are, these areas tend to be higher paid, have higher skilled jobs, and provide workers more control.

7. Implications

The findings of this study have important implications for U.S., Malaysian and Vietnamese managers. This research demonstrates that employees are not only satisfied and motivated by monetary rewards, but also nonmonetary areas. Recognition plays an important role in making employees feel valued and motivated and transcends national borders. Regardless of respondents' culture and economic development, recognition was found to affect their job satisfaction significantly. While a "one way fits all" approach to employee recognition does not provide the desired outcome, employee recognition strongly affects job satisfaction. This suggests that regardless of a country's culture (individualistic/collectivistic) and level of economic development (low, middle and high income), employees need to be recognized and praised for their contribution to the organization. As a result, companies must give more attention to the individual needs and circumstances of each employee. "One person's recognition may be perceived by another person as punishment (Islam & Ismail, 2004, p. 113)." Methods and techniques that are successful in one environment may be inappropriate in another. Gostick and Elton (2007) conclude from a survey based on 200,000 employees that employee recognition, long considered a benefit that costs money, can actually be a management tool that makes money; it is inexpensive to give, but priceless to receive. Finally, the importance of benefits to overall job satisfaction varies by country. It appears that, in countries with more progressive policies (e.g., the U.S.), benefits provide more impact on overall job satisfaction.

Job Satisfaction can be an important indicator of how employees feel about their jobs. Managers should be interested in their employees' job satisfaction because attitudes provide warnings about potential problems. Attitudes influence behavior (e.g., intention to quit, reductions in productivity, absenteeism, and turnover). Thus, it is imperative that managers, supervisors, human resource specialists, employees, and citizens in general should be concerned with ways to improve job satisfaction.

8. Conclusions and Future Research

This study concludes that both financial and nonfinancial rewards, as measured by pay, benefits and recognition have a role in influencing job satisfaction. Our findings extend previous research on job satisfaction by examining samples from three countries with different cultures and levels of economic development (GNI). This study provides further understanding regarding the perceptions of Americans, Vietnamese and Malaysians about factors that affect their job satisfaction. This finding has merit because previous research has demonstrated the link between job satisfaction and performance/productivity. Managers should consider the impact of the three rewards examined in developing effective recruitment and retention policies. This study adds to the literature on "job satisfaction" in that it empirically tests a large sample (N = 1195). Hence, this study has both practical and theoretical implications and demonstrates that employees are satisfied and motivated by both monetary and nonmonetary rewards.

While this study is an important step in understanding the impact of different types of rewards on job satisfaction, it also leaves some questions open for future research. While the study used student samples in three countries (Vietnam, Malaysia, and the U.S.), and the respondents (students) had some work experience, the findings may not be generalizable to the whole population. Hence, future research should be directed at examining the perceptions of full-time employees. Moreover, longitudinal research comparing students' perceptions regarding job satisfaction with their perceptions once they have been on the job for a period of time would provide additional information about the importance of these measures on overall job satisfaction. These factors may be more or less important at different times throughout an employee's career. Future research should try to replicate the current study in other Asian countries (collectivist cultures) before generalizing the findings.

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Measuring Company Management Efficiency: The Case of Real Sector of Economy

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Abstract: The paper presents theoretical framework for measuring managerial efficiency applicable for goods and services producing companies which based upon the closed list of general management functions introduced in the paper. The list of formalized and non-formalized criteria of management functions performance quality is formed within the suggested framework on the basis of qualitative and quantitative analysis. This set of criteria is used in order to estimate company's management quality rating which becomes the basis for management result estimation. It is also assumed that management system is costing company more than direct costs on its maintenance. The criteria of management entropy are presented in the paper, and this criterion is used for estimating real costs of management system performance. Henceforth efficiency of company management performance can be estimated as a ratio of corrected results and costs of management system performance.

Key words: performance and effectiveness; organization; structure; conceptual
JEL codes: M00, M10

1. Introduction

Measuring management system efficiency is one of major problems in contemporary world. It's which importance came into focus once again in times of global economic crisis. At this period it was mentioned a lot of times that hired managers were leading their companies to short-term results (which usually were the basement for bonuses estimation) which in a few cases were actually adulterated. This behavior can lead to the following problems. First, pursuit for short-term results can lead to long-term losses which can not be foreseen at the point of first results estimation. Second, it leads to growth of mistrust on the market which in return is decreasing the desire of possible investors or entrepreneurs to risk-due to the fact they feel they can be cheated by management. Those problems can be partly solved in case there would be a reliable instrument for quantitative measurement of management system efficiency which would allow the owner to understand what kind of effect hired managers produce: positive or negative.

One can also figure out a few reasons why the described problem is not solved up to now. In the first place, there is a problem of measuring the results achieved by management system. Those results are not equal to financial results achieved by the organization (though some researches (for example, Ushvitsky, Parakhina and Vasilyev, 2007) suggest they can be considered equal for estimation of managerial efficiency), at least due to the fact there is empirical evidence when companies achieved better results because their employees where ignoring

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managers' instructions while obeying informal leaders. This means that in order to measure management system performance efficiency one has to somehow extract the results of management system performance from the results achieved by the company. Second, the results achieved by company's management are being measured only in monetary terms though most of contemporary management concepts suggest there are at least some non-financial results (for instance, balanced scorecard) which are influencing company's profits. This is most obvious in real sector of the economy, so the one measuring management performance efficiency has to deal with a problem of monetary valuation of non-financial results achieved by the system of management. The third problem is the problem of estimating the customer interested in managerial efficiency measurement results. As it was mentioned, efficiency of management performance for managers themselves, investors and entrepreneurs or owners are quite different which should affect measuring instruments used by them. In this paper management efficiency measurement would be looked at from the owner's point of view. This means that maximum efficiency occur in case when company is achieving good results during a long period of time with minimum costs possible. Finally, the fourth problem with measuring managerial efficiency is that not only the results achieved by management system are unclear but the costs produced by management system are hard to be defined as well. Usually management costs are considered equal to cost of management system maintenance from accountant's point of view (Drury, 1997; Kerimov and Minina, 2002; Atkinson, Banker and Young, 2007). But this approach seems somewhat incorrect since there also are costs which occur due to mistakes of the company management which, in authors' opinion, should also be taken into consideration in order to define the level of management efficiency. All of the above means that management efficiency measuring instruments should be developed taking stated problems into account and allows making main hypotheses:

Hypotheses 1: Efficiency of management system can be quantitatively measured.

Hypotheses 2: Measurement of the effect of management system performance requires estimation of management quality level and considering this level within valuation process.

Hypotheses 3: Management costs include not only explicit costs, but also hidden ones produced by managerial mistakes.

2. Framework for Management System Efficiency Measuring

Solution of the managerial efficiency management measuring problem concerning the need for multidimensional management requires a creation of closed list of such dimensions (which would become a framework for processing hypotheses 2). An attempt to develop such a list was made, for example, within balanced scorecard concept (Kaplan, Norton, 1996) or within cultural transformation tools methodology (Barrett, 1997). But the main problem with those concepts in terms of managerial efficiency measuring problem is that they are dealing with the costs and results of company performance rather than performance of management system. But in order to measure results and costs produced by the system of management in case of estimating management system efficiency it is preferable to use a closed list of dimensions focusing on management process and structure of management performance itself. Classical management theory suggests that system of management is operates by means of management functions performance (starting with Fayol, 1930) or as a number of interrelated processes (see for example ISO standards). For quantitative measurement of management performance one needs some rigid construction so a set (closed list) of management functions would be in that case preferable.

For the purpose of this research we had chosen to look at the process of management as a complex performance of management functions. In classical theory of management there are five general functions of management (planning, organization, motivation, coordination and control) (see for example Griffin, 2003; Robbins and Coulter, 2007) the contents of which were revised within post-industrial and informational economy. For instance, management nowadays should consider dependence from other enterprises present in company's value chain, the situation of over-supply economy (which takes start in 1980 roughly), global focus on sustainable management and some other specific features which are influencing contemporary planning, organization, motivation, coordination and control. At the same time since Fayol the list of management functions itself had been revised and expanded. The following functions were considered as general functions of management by various authors: regulation and analysis (Smolkin, 1999), rationing, record keeping, regulation and stimulating (Paramonov, 1989), forecasting, regulation, record keeping, analysis, policy forming and responsibility (Goldstein, 2006), forecasting and goal setting (Popov, 1973). As we can see the amount of management functions is quite wide taking into consideration there are also special management functions such as logistics, marketing, production, supply etc. This means that in order to use a list of functions as a specification of actions on which management system spends resources the space of management functions should be somehow organized.

At first we need to mention that some functions that management system is performing in contemporary companies are missing from the list above. As it was pointed by Galbraith in "New Industrial Society" the companies are building technostructure; later the phenomena was studied thoroughly and named "development of organizational culture"—a set of informal contracts within the company which allow management achieve its goals using informal methods of management. Henceforth building organizational culture can be considered management function as well. Second, contemporary companies are putting a lot of effort into becoming society-friendly by means of being socially responsible. There is a lot of literature available on the issue of corporate social responsibility and the researches mainly agree that corporate social responsibility normally leads to increase in company performance. This means that forming the basement for corporate social responsibility can also be considered general management function, so the list of general functions should be expanded by those two.

The other thing that needs to be done in order to create a closed list framework for measuring management efficiency is to organize all mentioned by the authors general and special functions in some distinct order. Structuring the above stated functions one can focus on the following idea: some of the functions lead to achievement of management's main goals (planning, organization, motivation, coordination, control, informal organization—building organizational culture and developing corporate social responsibility) while other allow management to perform those general functions better (that is rationing, regulation, stimulation, record keeping, analysis, goal setting, forecasting etc.). The first set of functions henceforth can be addressed as basic general functions while the second set of functions can be named auxiliary general functions; it means, that management functions can be organized into three main dimensions as it is shown of Figure 1.

As it can be seen from the figure all management functions are interrelated and it is impossible to perform basic general without auxiliary general or special functions; but presented organization of management functions allows creating a closed list of functions performed by management system which includes seven basic general functions show on Figure 1.

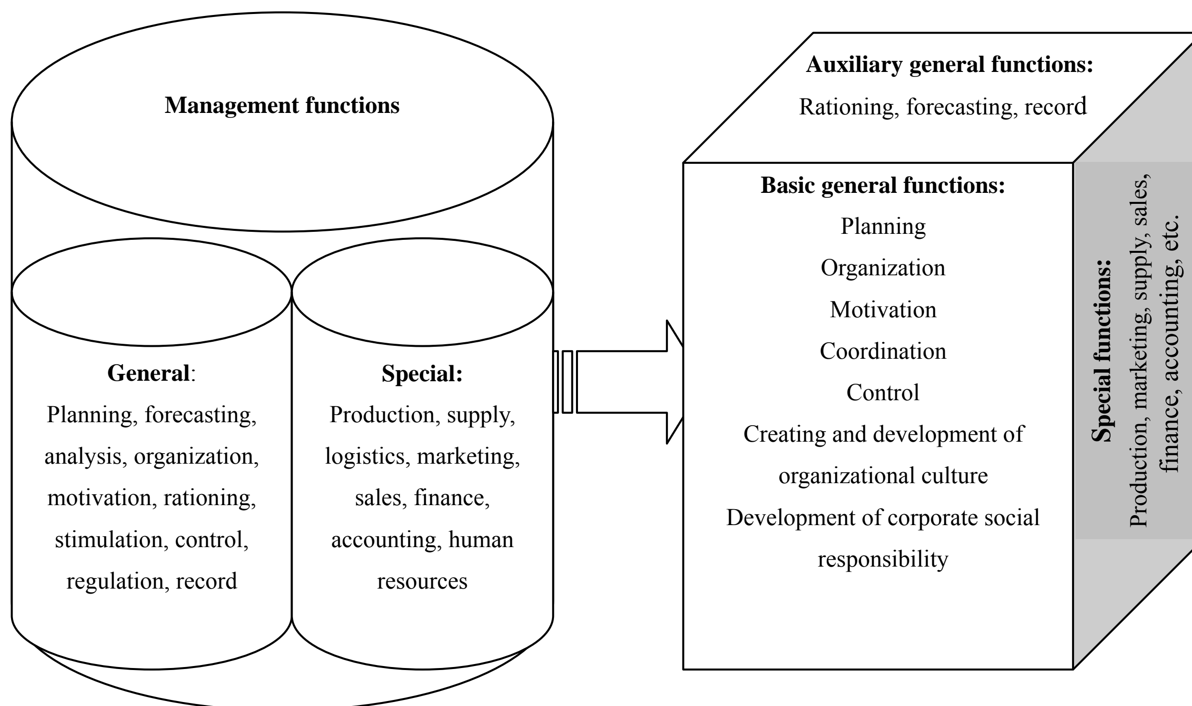

Figure 1 Restructuring Management Function Set

Later in this paper we will be creating a set of criteria for estimating the quality of performance for those seven functions, and this set would be used as a framework for management efficiency estimation.

3. Quality of Basic General Management Functions Performance Measuring

The next step on the way of estimating management system efficiency is to build up a set of criteria describing the quality of each basic general management functions performance. In order to create this set of criteria and estimate importance of each one of them an expert questionnaire was developed and offered to managers and experts from 195 Russian regional small, medium-sized and big enterprises doing business in real sector of economy (there were companies operating only within local or regional market as well as companies operating on the national and international level, which makes the achieved results reliable). In case of each function primary list of criteria was created on the basis of managers' and experts' opinion and included from 20 (for corporate social responsible responsibility development) up to 67 (for motivation) criteria which were mentioned by the respondents at least three times. After that linear correlation analysis considering each criteria and management effectiveness (in terms of achieving the results stated by management) was carried out. After that only criteria showing strong relation to those results were left on the list for further quality of management function performance estimation. The list of criteria which is suggested to be used in order to estimate the quality of planning is shown in Table 1.

The first criterion is a simple one and does not need any explanations for further use but is the one that has to be included in the list. The second criteria is dealing with the level of suppliers' and company's plans integration where 100% synchronization means company and its suppliers are sharing plans (for example, by means of electronic communication) and such situation is still very rare. If the level of synchronization is high, a company is usually being able to receive all the resources needed in due course. The third criteria is being estimated as a

simple average of the following particular criteria: (1) equivalence of human resources used to the level planned, (2) equivalence of material and technical and technological resources used to the level planned, (3) equivalence of financial resources used to the level planned, (4) equivalence of sales to the level planned, (5) equivalence of informational resources used to the level planned and (6) equivalence of intangible resources used to the level planned. This is an indirect indicator of plans quality describing plans' contents adequacy to the changes in external and internal environment. Finally, equity to liabilities ratio was chosen as a financial criteria describing the quality of planning function performance by the majority of respondents (90.06%) while correlation analysis proved the possibility to use this one in order to measure the quality of planning function performance.

Table 1 Planning Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Operating plans accuracy	± 0-0.5%	± 0.5-7%	± 7-15%	±15-25%	± 25-35%	> 35%	+86.14%
Level of plans synchronization with suppliers	99-100%	90-99%	75-90%	65-75%	50-65%	≤ 50%	+71.12%
Plans adequateness to the state of environment	99-100%	90-99%	75-90%	65-75%	50-65%	≤ 50%	+87.04%
Equity to liabilities ratio[1]	0.49-0.51	0.4-0.49 or 0.51-0.56	0.35-0.4 or 0.6-0.7	0.7-0.9	0.2-0.35	≤ 0.2 or ≥ 0.9	+72.58%

Ranges of values of the chosen criteria which are featured in the table were as well estimated by means of expert opinions summarization which was carried out according to the Delphi method. Managers and experts were asked to define the range within which they consider planning function performance "outstanding", "excellent", "good", "average", "poor" or "very poor". The results were summarized according to the procedure and shown in the table above.

The list of criteria which is suggested to be used in order to estimate the quality of organization is shown in Table 2. It was created according to the same procedure used in case of developing a list of planning function performance quality measuring criteria.

Organizational connection reliability indicator was introduced by A. Smolkin (Smolkin, 1999) together with the method for its quantitative measurement and the we are agreeing with the experts that is one should be used in case of organizational function performance quality estimation. The same applies to the second criteria, level of duplication which was researched thoroughly by A. Prigozhin (Prigozhin, 2007) who had also introduced a clear method for its quantitative estimation.

Table 2 Organization Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Organizational connections reliability	98.5-100%	90-98.5%	75-90%	65-75%	50-65%	≤ 50%	+83.41%
Level of duplication	0-0.5%	0.5-5%	5-12%	12-18%	18-25%	> 25%	-78.51%
Maximum span of control	≥ 30	14-30	8-13	5-7	3-4	< 3	+83.94%
Cells of management fulfillment	99-100%	95-99%	85-94.9%	75-84.9%	60-74.9%	< 60%	+70.19%
Managerial costs share in total costs	< 1%	1-7%	7-12%	12-20%	20-30%	> 30%	-94.72%

[1] These ranges of values were figured for machinery building enterprise and would be different for other spheres.

As for the third criteria, the span of control, we suggest a different from traditional approach towards its estimation. Usually span of control is being estimated as some constant value individual for each organization; we would like to emphasize that span of control (SC) is a variable defined by two factors: organization's specific characteristics (k_{ind}) and the amount of separate managerial units regulating single operation (k_{imou}). Henceforth maximum span of control which is the third criteria featured in Table 2 can be estimated in the following way:

$$SC_{max} = k_{ind} * k_{imou} \quad (1)$$

In the given formula both coefficients are to be defined for each organization. First, k_{ind} is defined by adding to the amount of two (two is a minimum span of control acceptable within an organization) correction coefficients (+1, 0 or -1) which are featured clearly in Table 3 below:

$$k_{ind} = 2 + \sum_{i=1}^{7} k_{cvi} \quad (2)$$

Where k_{cvi} is the correction value of each individual factor influencing the span of control, featured in Table 3;

i (1÷7)—serial number of an individual factor (the number of factors was chosen in order to keep the total in suggested range of 7±2 (Miller, 1956).

Table 3 Correction Coefficients for Kind Valuation

Name of the factor	Value of k_{cv}		
	-1	0	+1
Psychological type of the manager	Despotic	Authoritarian	Democratic
Formal and informal leadership coincidence	In most cases there is no coincidence	Coincidence occurs roughly in 50% of the cases	In most cases there is coincidence
Attitude towards authority delivery	Negative, the process of decision-making is highly centralized	Authority can be delivered for decisions of minor importance	Decisions are mainly made at the level of their future implementation
Level of understanding of correlation between employees' and organization's results	Employees rarely see correlation between their own results and organization's performance	Employees consider some successes and failures of organization as their own	Employees consider almost all of company's successes and failures as their own
The level of external environment predictability	Very high level of unpredictability (introduction of a totally new product to the market)	High level of unpredictability (introduction of modified products to the market)	Relatively low level of unpredictability (not considering the cases of force majeure)
The level of disturbance in organizational communications	Irrelevant information occupies 60-100% of total information within organization	Irrelevant information occupies 30-60% of total information within organization	Irrelevant information occupies less than 30% of total information within organization
The level of correspondence between types of jobs and types of employees personalities[2]	The type of job is rarely corresponding to employee's personality	The type of job is corresponding to employee's personality occasionally	The type of job is corresponding to employee's personality in most of the cases

As it can be seen from the above, maximum value of k_{ind} coefficient is 9 while the minimum value is -5; in case this coefficient is lower than +2, organizational function should be considered misperformed. The second coefficient used in the formula (1) is estimated according to the type of organizational structure. In case of classical bureaucracies it is equal to 1 because in this case there should be only one manager responsible for certain operation performance. In case of matrix organizational structure there are two managers that can be independently dealing with one operation which means in that case k_{imou} is equal to 2; in case of virtual, network,

[2] according to Holland's classification

module or other contemporary flat organizational structure this coefficient can be greater than 2 which allows getting span of control much higher. Maximum span of control criteria should not be used by itself; it is also relevant to see the fulfillment of managerial cells (100% fulfillment means every manager is in charge of maximum amount of people possible). Finally the financial criteria describing the quality of organizational function performance according to correlation analysis is management costs share in total costs of the enterprise. As it had been mentioned for planning function, the ranges shown in Table 2 are the results of expert opinion processing according to Delphi method.

Table 4 Control Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Structure of deflections	0.97-1.0/ 0-0.05/ 0-0.01	0.7-0.97/ 0.05-0.2/ 0.01-0.1	0.6-0.7/ 0.05-0.3/ 0.01-0.2	0.4-0.6/ 0.2-0.3/ 0.1-0.3	0.3-0.4/ 0.2-0.4/ 0.3-0.7	0-0.3/ 0.3-0.7/ 0.3-0.7	+72.81%
Dynamics of indicators used for control	0-0.5%	0.5-5%	5-7%	7-12%	12-20%	> 20%	+80.76%
Share of non-formalized indicators used for control	0-0.5%	0.5-3%	3-5%	5-8%	8-15%	> 15%	+88.21%
Level of internal transparency	See Table 5 for explanations						+92.65%
Indirect to direct costs ratio	< 5%	5-25%	25-50%	50-80%	80-150%	> 150%	-77.14%

The list of criteria which is suggested to be used in order to estimate the quality of control is shown in Table 4. It was created according to the same procedure used in case of developing a list of planning function performance quality measuring criteria.

The first indicator presented within the table is a complex one and consists of three sub-indicators: the share of deflections revealed at the stage of preliminary control (S_{pc}), the share of deflections found at the level of current control (S_{cc}) and the share of deflections found at the stage of closing control or as a result of feedback procedures (S_{cfc}). In the Table 4 the level of this certain criteria is shown in the format $S_{pc}/S_{cc}/S_{cfc}$. In order to figure out correlation the highest point was given to the situation when maximum deflections were revealed on the stage of preliminary control. The second indicator featured in the table is the main characteristic of control system stability, which means the higher percentage there is, the more indicators used within the process of control, management is changing annually. When this list is being changed rapidly company management is unable to do comparative analysis and is in fact confusing personnel. Both of those factors lead to worse performance of the enterprise. The same logic can be used for the third indicator, the share of non-formalized indicators. If this share is high, the results of control tend to become subjective which causes decrease in control effectiveness (the result is management system malfunctioning which is proved by high correlation coefficient). The fourth criteria describing control function performance is a level of internal transparency which quite a few Russian enterprises lack. This indicator is the one that is difficult to measure directly, so we are suggesting to estimate it as a three-factor integrated coefficient. The suggested approach towards estimation of the internal transparency level is shown in Table 5.

As it can be seen from Table 5 the level of internal transparency is estimated on the basis of three characteristics which are implicitly describing the level of trust and cross-checking within the company. Those characteristics were named by majority of respondents when they were offered the list of internal transparency indicators within the second round of questioning produced for the needs of this research. The last indicator of control performance quality (indirect to direct costs ratio) was also named by majority of respondents. The idea

behind choosing this particular index is that high level of indirect costs points out that a big amount of money company spends does not have a clear basis which means they are hard to be controlled.

Table 5 Level of Internal Transparency Estimation

Quality of performance	Non-productive costs to productive costs ratio	Fulfillment of management cell (%) before new cells are created	The amount of cross-checking performed for the needs of one process
Outstanding	< 5%	Full	0
Excellent	5-30%	95-100%	0
Good	30-60%	90-95%	1
Average	60-90%	80-90%	2
Poor	90-110%	60-80%	3-4
Very poor	> 110%	< 60%	> 4

The list of criteria which is suggested to be used in order to estimate the quality of coordination which was created by the same procedure, is shown in Table 6.

Table 6 Coordination Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Amount of consecutive adjustments in a process	0-0.5	0.5-2	2-3	3-5	5-7	> 7	-83.06%
System reaction towards changes	Completely adequate	Adequate	A little ex-aggerated or under-estimated	Inadequate, exaggerated	Inadequate, underestimated	No reaction	+82.15%
Current assets to current liabilities ratio	-	1.4-1.8	1.0-1.4	1.8–2.0	0.95-1.0 or 2.0-2.5	< 0.95 or > 2.5	+71.02%

Estimation of the first suggested criteria is to be carried out on the basis of sampling process. In this case the one testing amount of consecutive adjustments in a process has to make sure he is testing main, auxiliary and management process. The simple average estimated in the end is the basis for valuation of coordination function performance quality. The second criteria featured in the Table 6 is (as it can be seen) a non-formalized one. In order to valuate it one has to carry out some kind of expert opinion valuation. Though this criterion can not be defined distinctly, it was put on the list of indicators for coordination quality valuation by 92.8% of the respondents and being tested by linear correlation analysis had shown quite high level of relevance. Both those reasons led to the fact that this criterion was included into the list. Finally the ratio of current assets to current liabilities was considered as financial indicator of coordination function performance quality because this one is an index describing enterprise’s short-term financial responsibility. Henceforth it is the one that can be brought back to the desired level in a short period of time (less than one year) in case management system is showing adequate reaction towards the changes in internal and external environment. The specific values presented in the Table 6 are the ones suitable for Russian heavy machinery building enterprises[3] and are to be changed for other companies from the real sector of the economy. The suggested ranges are put into the table in order to show the main approach towards valuation of the third suggested coefficient used for coordination function performance quality estimation.

[3] Those ranges for current assets to current liabilities ratio are based upon the data of 25 Russian heavy machinery building companies, and it has to be emphasized that this criteria is highly variable according to the field where a certain company is acting.

The list of criteria which is suggested for use in order to estimate the quality of motivation function is shown in Table 7. The procedure for making the list itself (Svirina, 2009) and estimating the ranges describing certain quality of motivation on the basis of suggested criteria is being the same as was used for planning, organization, control and coordination functions.

Table 7 Motivation Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Level of employee satisfaction[4]	98-100% satisfied	Over 70% employees satisfied	50% employees satisfied, 50% are not satisfied	Over 70% employees are not satisfied	Over 70% employees are not dissatisfied	Over 50% employees dissatisfied	+74.57%
Level of job and employee's motivation profile coincidence	99.5%-100%	93-99.5%	85%-93%	75%-85%	60%-75%	< 60%	+72.23%
Level of stimulation adequacy	See Table 8 for explanation						+92.74%
Level of moti-vation profile and stimulation deflection	± 1% and less	± 1-10%	± 10-15%	± 15-25%	± 25-50%	± 50% and more	-87.62%
Level of employee creativity (employee innovative suggestions implemented)	98-100%	80-98%	60-80%	30-60%	10-30%	< 10%	+86.90%
Labor productivity (thousand rub-les per person annually)	> 2500	700-2500	550-700	400-550	200-400	< 200	+90.26%

At first it is worth mentioning that estimation of motivation function performance quality proposes demand for non-formalized criteria use. At the same time within the survey we have stated as one of our goals to keep the amount of those as low as possible. The first criteria, featured in the table concerns employee satisfaction in terms of Herzberg motivation theory which implies 4 states of employee's satisfaction level. This can be measured by means of questionnaire and correlation index of this criterion is high enough. Estimation of the next three criteria (level of job and employee's motivation profile coincidence, level of stimulation adequacy and level of deflection between motivation profile and stimulation implemented) requires introduction of methodical approach developed for coincidental measurement. The suggested approach is based upon Gerchikov motivation theory (Gerchikov, 2003) which implies there are five main motivation types (instrumental, professional, owner, patriotic and escaping). Each of those motivation types is requiring special stimulation and is suitable for certain jobs which is also featured in Gerchikov's published work together with the questionnaire for employee's motivation profile estimation. The profile means that Gerchikov was taking into account that almost all of the employees have qualities that are characterizing them as a representative of different motivation types (an example for two employees is shown on Figure 2) which is presented on a five-scale diagram.

For the needs of this research we were assuming that job and motivation profile coincidence as well as the level of deflection between motivation profile and stimulation implemented are to be defined according to the basic motivation of employees.

[4] In terms of Herzberg theory.

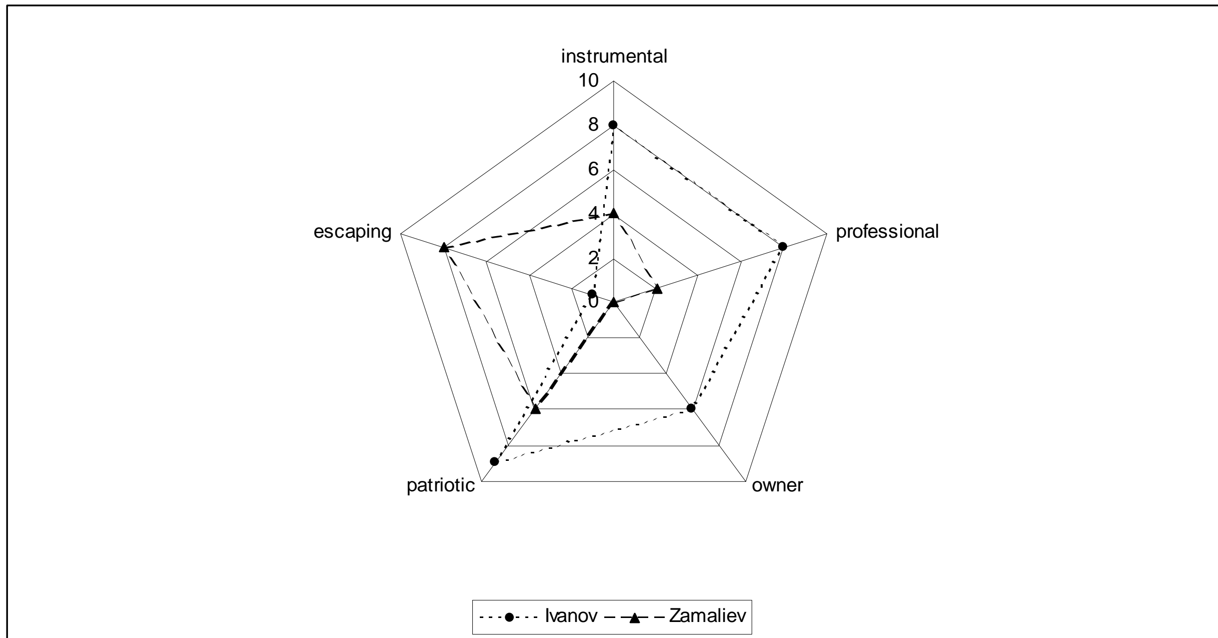

Figure 2 An Example of Employee Motivation Profile

Percentages presented in Table 7 are given assuming that 100% is total amount of company employees. The level of stimulation adequacy is a non-formalized criteria and its ranges are featured in Table 8.

Table 8 Level of Stimulation Adequacy

The level of motivation profile and stimulating measures deflection	Quality of motivation function performance
Statistically insignificant deflection level	Outstanding
Almost no deflection	Excellent
Low deflection, even for all 5 scales	Good
Significant deflection on 1 scale	Average
Significant deflection on 2 or 3 scales	Poor
Significant deflection on 4 or 5 scales	Very poor

This particular criterion remains non-formalized due to the fact it that expert opinions on percentage ratios representing significance and insignificance were showing high level of unconformity and it was decided it would be better to leave estimation of significance to experts dealing with certain companies. It can be explained by the fact that sometimes inadequate stimulation of a few people can be significant in case they are the ones making decisions so it seems admissible to leave this criterion as a non-formalized one.

The fifth criterion is a formalized one and is used for valuation of employee creativity level. It is also assumed that company personnel is being creative in case people are motivated and according to Japanese experience company efficiency is rising in case employees are interested in constant improvement. The sixth criterion is again a financial one suggested by the majority of respondents as well as previous researches. The ranges given in Table 7 are the ones estimated for Russian machinery building enterprise and are to be changed in case of other country or sphere of activity.

The next management system function which is performed by contemporary enterprise's management, featured in this research, is creation and development of organizational culture as an informal way of management.

The list of criteria which is suggested for use in order to estimate the quality of organizational culture creation and development function is shown in Table 9. The procedure for making the list itself and estimating the ranges is the same as was used earlier within this research.

Table 9 Creation and Development of Organizational Culture Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Amount of employees and company's matching values	10	9	6-8	3-5	2	< 2	+77.42%
Level of cultural entropy	< 1%	1-6%	6-10%	10-15%	15-30%	> 30%	-72.34%
Value leverage level	< 1%	1-10%	10-25%	25-50%	50-70%	> 70%	-81.14%
Synergetic effect	Resources efficiency increases 10 times or more	Resources efficiency increases 2.5 to 10 times	Resources efficiency increases 1.5 to 2.5 times	Resources efficiency increases 1.01 to 1.5 times	No synergetic effect	Negative synergetic effect	+84.21%
Net profit to income ratio	> 40%	12-40%	7-12%	3-7%	0-3%	< 0%	+86.71

First two criteria featured in Table 9 were introduced by R. Barrett (Barrett, 1997) who also features the methodology for their estimation within his concept of cultural transformation tools concept. For the needs of organizational culture quality estimation this methodology is highly suitable since it allows measurer to get concrete figures describing the quality. At the same time those two criteria are not allowing to estimate the relation between company performance and the level of organizational culture development. Such a criterion was developed for the purpose of this research and was named value leverage (to show its analogy with operational leverage) and shows by what share would company profits increase (decrease) in case the amount of employees sharing values of the company increase by 1%:

$$VL = \frac{\sum_{i=1}^{n} \frac{\Delta P_{sal}}{\Delta A_{evs}}}{n} * 100\% \quad (3)$$

Where VL—value leverage, %;

i—the number of periods analyzed;

ΔP_{sal}—variation of profit received from the main activity of an enterprise (gross profit deducted by commercial and managerial costs);

ΔA_{evs}—variation of the number of employees sharing company values (and satisfied).

Another criterion suggested for estimation of organizational culture creation and development quality is the level of synergetic effect produced by the company since this indicator shows how formal and informal structures are collaborating. This particular criteria is again the one which can not be formalized and has to be estimated with the help of experts, but the ranges suggested in Table 9 by the respondents are showing a measuring aspect which can not be estimated accurately but can be usually put within a certain range. Finally financial criteria chosen by the respondents (net profit to income ratio) is also measuring the efficiency of formal and informal structures collaboration indirectly. As it was mentioned for coordination and motivation functions the ranges of net profit to income ratio were estimated for the case of Russian machinery building enterprises and are to be changed for other spheres of economic activity.

The last basic general function of management, featured in this research, is development of corporate social responsibility which is representing the company collaboration with society, customers and suppliers in terms of mutual trust mostly.

The list of criteria which is suggested for use in order to estimate the quality of corporate social responsibility development function is shown in Table 10. The procedure for making the list itself and estimating the ranges is the same as was used earlier within this research.

Table 10 Development of Corporate Social Responsibility Quality Estimation Criteria

Name of criteria	Quality of performance						Correlation to management effectiveness
	Outstanding	Excellent	Good	Average	Poor	Very poor	
Rejection rate of goods and services	0-0.5%	0.5-4%	4-7%	7-15%	15-25%	> 25%	-82.12%
Share of corruption-based costs in total costs	< 1%	1-7%	7-15%	15-20%	20-40%	> 40%	-76.84%
Share of labor contract violation in total interactions with employees	0-0.1%	0.1-1%	2-4%	4-7%	7-10%	> 10%	-71.06%
The share of reclamations processed properly	> 99.7%	98-99.7%	90-98%	80-90%	60-80%	< 60%	+79.84%
Share of deals done on terms prepayment	< 0.5%	0.5-10%	10-25%	25-40%	40-70%	> 70%	-91.73%

It is worth mentioning that for the needs of this research we were assuming that in case of Russian where corporate social responsibility is rarely present the contents of this term are a little different from the one used in Western literature (for example, Goyder, 1961; Henriques, 2003). In case of Russia a company can be addressed as socially responsible in case it is fulfilling its liabilities before employees, customers, suppliers and society since legal legislation acts and the state of judicial authority allows enterprises to ignore or override written law frequently (which is hopefully not the case for Western economies). This reasoning was behind the choice of criteria made by majority of our respondents which is featured in Table 10. The first criterion chosen is rejection rate which represents company's responsibility before customers. The ranges shown in the table were figured for Russian regional production enterprises where 20% rejection rate is a common case. The second criteria (share of corruption-based costs) ranges were estimated by respondents who were assuming that 10% rate is maximum level of unavoidable corruption-based costs (which occur in case legislation acts are stated in a way when it is impossible to present entrepreneurial activity without breaking any of them). So 10% is considered to be some kind of corruption "background emanation" (it differs for different types of entrepreneurial activity, but the average figure seems quite correct). Violations of employees labor contracts are also quite common which is the reason for the choice of third criteria from the table. Same reasoning is behind the choice of criteria characterizing the level of properly processed reclamations. Judicial practice present today allows enterprises to leave quite a few reclamations even unanswered which makes it sort of a good will gesture to deal with reclamations according to proper procedure (in a few spheres there are no regulations of that procedure). Finally the financial criteria chosen by respondents (share of deals done on terms prepayment) is the one characterizing the level of trust an enterprise have with its partners which shows high correlation with management effectiveness.

As it can be seen from the described approach towards estimation of management functions performance quality is a process which involves valuation of a number of coefficients and seems to give a distinct picture of company management quality. The next step taken in this research is to define results produced by the system of management in relation to its quality.

4. Management System Results Measurement

As it was mentioned earlier one of the problems with management results estimation is that it is unequal to enterprise's results though the quality of management performance affects the last greatly. Next, for quantitative management only monetary units can be used which leads us to the problem of measuring results produced by the system of management in monetary terms.

In order to solve those problems one has to consider the following things. First of all, the result produced my management system is a part of company result, and we can assume, that the higher the quality of management function performance is the higher is the role of management system in achievement of company results. On the opposite the lower quality of management is the lower is the impact of this system on company's results (in this case system of management is often affecting the company results negatively, and if company is keeping to achieve positive results it is usually due to the fact employees are in fact ignoring instructions given by management). At the same time one can not consider company's management activity efficient if the enterprise is getting negative financial result—even in case overall quality of management function performance is relatively high (such a situation can occur in case of country club management (Blake, Mouton, 1964).

Taking into consideration those two problems, we have developed the following method of management system result estimation. First of all the types of management systems are divided into 6 types:

0 class—highly efficient management system producing positive synergetic effect;

1 class—efficient management system which is performing all seven management functions with excellence;

2 class—enterprises with good management system which is performing basic general management functions efficiently with a little misbalance;

3 class—capable management system which can be improved in terms of management functions quality increase;

4 class—misbalanced and in many cases incapable system of management;

5 class—malfunctioning management system, if an enterprises keeps functioning it is due to external reasons or the result of informal management system performance.

Estimation of management system quality is supposed to be carried out according to the following procedure:

$$QP = \sum_{i=1}^{33} c_i \tag{4}$$

Where QP is the amount of points characterizing the quality of management system;

i—criteria, characterizing the quality of basic general management functions performance, described above (total amount of those is 33);

c—points, received by enterprise's management system for each individual criteria (where "outstanding" means by this criteria management system should be graded by 8 points, "excellent"—by 5 points, "good"—4 points, "average"—3 points, "poor"—2 points and "very poor"—1 point).

Henceforth maximum points a regular management system can receive is 165 (33*5) points. This level would be considered a maximum regular level (outstanding management performance should be graded higher) for the needs of management results estimation.

In case an enterprise has losses, the quality of management system within its valuation has to be decreased. The level of decrease needed was estimated on the basis of expert opinions who considered the following. In case an enterprise is having losses on the level of gross profit the quality of management has to be decreased by 3

classes (which means 4th class becomes maximum quality level of management system). In terms of points it means 60 points should be subtracted from the sum estimated according to the formula (4). It also has to be mentioned that gross losses have to be seen at least two periods in a row in order to exclude the situation when company management did not have time to react to force majeure. Same is true in case company has losses at the level of EBIT—in order to make a correction of management quality level in this case class of management should be decreased by two classes, which means 40 points should be subtracted from the sum estimated according to the formula (4). Finally, in case of net losses they should occur three periods in a row, and in this case the quality of management system should be decreased by one class by subtracting 20 points from the sum of individual characteristics (estimated by formula (4)).

The points received become the basement for estimation of management system quality class. In case management system receive over 165 points it can be rated as class 0; if it receives from 146 to 165 points—class 1; from 136 to 145 points—class 2; from 106 to 125 points—class 3; from 81 to 105—class 4 and less than 81 point—class 5. Those ranges were estimated within the process of expert's opinion valuation carried out according to Delphi method.

Finally, the comparative ratio of points received by system of management and maximum regular points becomes the correction coefficient which shows which part of company result can be considered the one achieved due to management system functioning:

$$Ef_{man} = Pr * \frac{P_{fact}}{P_{\max}} \tag{5}$$

Where Ef_{man}—effect (in monetary terms), produced by the system of management;

Pr—profits earned by the enterprise (the type of profit used in this formula can be chosen in each case according to the type of analysis carried), monetary units;

P_{fact}—points earned by particular management system;

P_{max}—maximum quality points received by regular management system, 165 points.

This procedure allows to measure monetary value of results produced by the system of management. Within the suggested procedure two main problems of management system efficiency estimation problems are solved. First, the procedure allows to clear out the result produced by formal management while subtracting the part of result which is achieved by the company due to internal or external changes or due to efficient performance of informal management and communication systems. Second, the suggested procedure allows one to valuate effect produced by system of management in monetary terms which is essential for performing different types of comparative analysis.

5. Evident and Failure Managerial Costs Measurement

According to hypotheses 3 stated in this paper, in order to estimate management system efficiency one has to develop a tool for measuring both evident and hidden management costs. According to most of the authors managerial costs are considered to be direct costs arising due to activity of management system (for example, Bakaev, 2010) which are included into cost price. Those costs include manager's salary and salary-based payments, materials, amortization and other costs which occur due to development and performance of the system of management. But those costs are only a part of expenses an enterprise has due to management system activity. In case there had been a mistake made by management, an enterprise has to carry additional expenses in order to

smooth down the consequences of this mistake. Coincidental costs would include not only evident managerial, but as well regular costs the enterprise usually has: personnel salary and related payment, raw materials, transportation etc., but in case there was no mistake made by management, those costs would never occur. This allows us to consider those costs as a result of management system functioning—as hidden managerial costs. There also is no doubt that low quality management systems tend to produce more hidden costs than high quality ones.

This situation requires a tool for estimation of hidden costs. There is a resembling problem in quality management when one wants to estimate total costs of rejection, and it is suggested by some authors (Harry, Shreder, 2003). Since managerial mistakes usually lead to non-eliminable consequences total managerial costs (including the ones arising due to managerial mistakes made) can be estimated in the following way:

$$C_{man\ t} = C_{man} * \frac{1}{1 - E_{man}} \tag{6}$$

Where $C_{man\ t}$—total managerial costs in their regular meaning, including those that arise as a result of management mistakes within management system, monetary units;

C_{man}—evident costs which are the result of management system activity, monetary units;

E_{man}—level of management entropy (level of management malfunctioning), share (0÷1).

The next problem arising is quantitative measuring of managerial entropy. Managerial entropy characterizes on the one hand the share of resources (labor, financial, temporal etc.) which are spent due to the fact that managers do not have algorithms and instructions for solutions of the problems that occur regularly. On the other hand this level represents additional costs that enterprise has to have due to mistakes made by its managers or occurring as the result of management system malfunctioning. The level of managerial entropy is more difficult to estimate than rejection rate (which is used in case of quality management) since one can not use methods of technical control which can be used in products quality management. Henceforth we suggest the following procedure for managerial entropy estimation. On the first stage it includes expert valuation of resources losses level which is the result of the fact that a company has additional demand in managerial regulation of typical processes, together with expert valuation of the waste level of extra resources which is due to management system malfunctioning (the reason of malfunctioning in this case does not matter). On the second stage a control procedure should be performed. At first the information which is formalized and arranged on the top-management level (in the form of orders, oral explanations, instructions etc.) is compared same documents as they are understood by executor. In order to make this comparison executor is asked to write down his interpretation of the document and than those two documents are compared. Next, the amount of corrections performed by enterprise's management in order to receive the desired result can be estimated which also an indirect indicator of management is malfunctioning level. On the basis of those procedures an average level of managerial entropy should be estimated and used in formula (6) for measuring of evident and hidden direct costs of management system functioning.

At the same time management system malfunctioning is leading as well to extra costs in production, commercial activity and so on (in fact those are the ones that would not have happened if management did not make mistakes). Those extra costs can be measured in the following way:

$$C_{tot\ man} = \sum_{i=1}^{n} C_i * \frac{1}{1 - E_{man}} - \sum_{i=1}^{n} C_i \tag{7}$$

Where $C_{tot\ man}$—enterprise's extra costs (excluding direct managerial) arising as the result of management system malfunctioning, monetary units;

i (1÷n)—types of resources consumed by the enterprise;

C—expenses occurring within entrepreneurial activity of the enterprise due to use of certain resource, monetary units.

The second item in the formula (7) is added in order to exclude direct costs of enterprises' production and commercial activity. Henceforth total costs produced by management system (evident and hidden) can be estimated in the following way:

$$C_{man} = C_{man\ t} + C_{tot\ man} \tag{8}$$

This means that growth of management based costs of an enterprise has an non-linear trend depending on the level of managerial entropy (see Figure 3).

As it can be seen from the Figure (the example given there assumes direct evident managerial costs are equal 100 monetary units, enterprise is using only one resource for production and it costs 400 monetary units during the period) even at the 0.1 level of managerial entropy management based costs increase 1.56 times in comparison to the situation of zero entropy level.

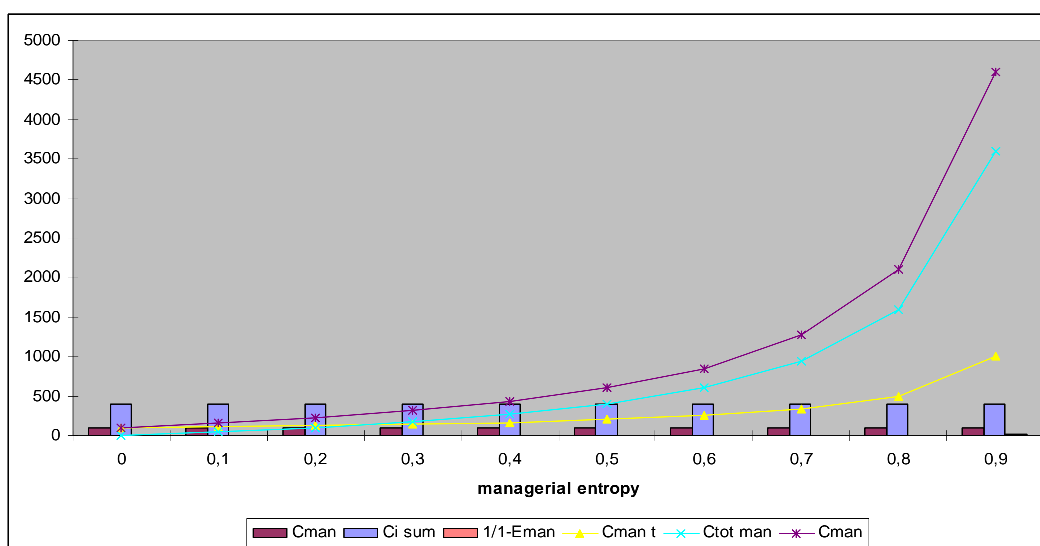

Figure 3 Total Management Based Costs in Dependence of Managerial Entropy Level

In case managerial entropy level comes to 0.4 management based costs exceed production costs. If entropy comes to the level 0.8 management based costs are 21 times higher than in case entropy is equal to 0. This emphasizes that idea to assume the costs which occur in production due to management system malfunctioning as production costs lead to huge underestimation of true expenses of management, especially malfunctioning management.

6. Management System Performance Efficiency Measurement

According to the classical definition of efficiency (Emerson, 1909) it should represent some kind of correlation between results produced by management system and management based costs. An approach towards definition of both had been presented above in this paper. Henceforth quantitative estimation of management system efficiency can be carried out in the following way:

$$MEff = f(Ef_{man}, C_{man}) \quad (9)$$

Meanwhile, if the effect of management system performance was measured on the basis of gross profit (as it was suggested earlier in the paper, one can choose type of profit used for managerial result estimation), the estimated efficiency should be addressed as the efficiency of main production management; if the effect was estimated on the basis of earnings before interest and taxes, coincidental efficiency can be addressed as efficiency of production and investment management; finally, in case net profit was used the coincidental efficiency can be addressed as general efficiency of management system performance. This last efficiency is considered the most relevant one, which gives the best characteristics of management efficiency.

It also has to be mentioned that management system performance efficiency can be estimated as a simple ratio of managerial effect (result) and costs (which is the simple relative efficiency coefficient). In this case one should perform some additional operations in order to get an interpretable result. At first maximum efficiency for certain enterprise should be estimated. According to procedure featured in this paper maximum management result ($Ef_{man\ max}$) is equal to profit earned by the company (that would happen in case management system is of excellent quality and receive 165 points). Then, minimum management based costs ($C_{man\ min}$) occur in case managerial entropy is equal to zero and those costs are equal to those in the meaning from accounting point of view. Than maximum management efficiency of a certain enterprise ($Meff_{max}$) would be a ratio of maximum management results possible for certain enterprise to minimum management based costs:

$$Meff_{max} = \frac{Ef_{man\ max}}{C_{man\ min}} \quad (10)$$

Than management efficiency estimated according to procedure suggested in the paper should be compared to maximum efficiency:

$$RMeff = \frac{Meff_{fact}}{Meff_{max}} * 100\% \quad (11)$$

Where RMeff is relative coefficient characterizing the level of management efficiency, %;

$Meff_{fact}$—efficiency of management system, estimated according to the procedure featured in this paper, share.

If RMeff is close to 0 management system is highly inefficient, if it comes up to 1—management system is efficient. Some results of practical analysis of management efficiency in case of some Russian enterprises are presented in Table 11.

Table 11 An Example of Management Efficiency Estimation

Indicator	Zelenodolsk plant named after A. M. Gorky	Chistopol watch-building plant “Vostok”	Kazan helicopter building plant
Net profit, roubles	1 378 000	852 000	1 541 561 000
Management results, roubles	886 261	402 764	943 622 187
Management costs, roubles	90 092 000	13 211 000	2 612 620 200
Corrected management based costs, roubles	123 727 480	32 880 047	2 875 508 140
Management efficiency	0.0071	0.0122	0.3281
Maximum management efficiency[5]	0.0133	0.0645	0.5900
Relative management efficiency	53.38%	18.91%	55.61%

[5] It is also worth mentioning that quite a few authors assume this is managerial efficiency. One can see from the Table that such approach leads to great underestimation of true role of management in enterprise’s performance in the market.

The analysis of these three companies performance after management efficiency was estimated as featured in Table 11 had shown that Kazan helicopter building plant is increasing profits with a higher pace than Zelenodolsk plant, while "Vostok" plant went bankrupt in 1.5 years time after the above shown analysis was carried out.

In some cases more complicated indicators of managerial efficiency can be used, for example, and analog of net present value (concerning management effect and costs only) or modified for management system efficiency estimation needs internal rate of return, which can be estimated as follows:

$$\sum_{i=1}^{n} \frac{Ef_{mani}}{(1+IRR_{man})^i} - \sum_{i=1}^{n} C_{mani} = 0 \qquad (12)$$

Where IRR_{man} is a IRR-based management system efficiency valuating coefficient;

i (1÷n)—number of the periods taken into consideration for analysis.

The choice of a certain efficiency coefficient depends on the type of analysis carried and expected results of this analysis.

7. Conclusions

Three hypotheses were stated within the presented paper. In order to prove major hypotheses, stating that efficiency of management system performance can be measured, two minor hypotheses were tested. It was estimated that results produced by the system of management can be estimated by means of correcting company profits by the coefficient which characterizes the quality of management system performance. In order to create this coefficient a special framework based upon closed list of basic general management functions was developed—this was created in order to prove the second hypotheses. It was also estimated that management based costs include both evident managerial costs and hidden costs. The hidden costs can be estimated on the basic of measuring the level of managerial entropy, a concept introduced in this paper. This approach was developed within the proving of third hypotheses. On the basis of estimated effect and costs produced by the system of enterprise's management the efficiency of management system can be figured out which is the proof of major hypotheses. An example presented in the end of the paper proves that suggested method is providing a better understanding of real management system efficiency than traditional ones.

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Enterprise Risk Management under Sustainability Platform

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Abstract: Enterprise Risk Management (ERM) has become the most important part of management for all organizational types. As a consequence of globalization, public expectations have risen that businesses should behave responsibly and accountably in terms of minimizing their environmental and social impacts. Most private organizations have developed ERM system to take into account shareholders' interests. However, existing ERM frameworks fail to address sustainability risk as a core component even though sustainability is crucial for ERM. The area of volatility included in ERM framework should be extended to include emerging sources of instability in environment and society if the organization is to achieve robust growth and create wealth in the long run. This paper proposes ERM framework under sustainability platform and discusses required roles of board of directors and senior executives.

Key words: sustainability; enterprise risk management; environmental issue; social impact
JEL codes: M14, M19, D81

1. Introduction

Risk management used to be practiced only among financial institutions like banks, insurance companies, and securities firms. Risk management frameworks for these financial institutions have been developed through time, but existing frameworks cover only three main risk categories: credit risk, market risk, and operational risk, with an additional underwriting risk for insurance companies.

For non-financial institutions, risk management has become a significant component of management. The most cited framework is the one by Committee of Sponsoring Organization of the Treadway Commission (COSO) Enterprise-wide risk management, which has been developed since 2003 after the enforcement of Sarbanese-Oxley (SOX) Act in 2002. Even though the framework was meant for the US companies to be able to comply with the SOX Act, it is widely accepted as ERM framework in many countries, including Thailand. The areas of risk being considered in the COSO ERM framework include strategic risk, operational risk, financial reporting risk, and compliance risk.

Clearly, all of these frameworks do not address sustainability risks, which could be one of the most critical risk areas for both financial and non-financial institutions. Sustainability is defined by the Bruntland commission as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. The meaning of sustainability is more pronounced with the concept of "Triple Bottom Line" introduced by John Elkington in 1997. He suggested that corporate sustainability required not only economic bottom line but environmental and social performance as well.

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Over time, there is an effort of shareholders to pressure the firms to pay more attention on sustainability risks. One example is the Coalition for Environmentally Responsible Economies (CERES), which has worked extensively on pressuring the companies to adopt sustainability concepts in their ERM practices. CERES together with the Interfaith Center on Corporate Responsibility (ICCR) representing 275 faith-based institutional investors with combining holdings of around $90 billion have been active in sponsoring the filing of shareholder resolutions on global warming.

The debate on whether global warming impacted businesses and society is now over. Increasing emissions and concentration of greenhouse gas in the atmosphere are effectively thickening the blanket and causing temperature to rise. Environmental and social risk resolutions are brought up against not only big carbon producers and users of energy products, but also companies whose operations harm the environment and society. In most countries, directors and senior officers may face penalties and litigation for failure to effectively manage sustainability risks. Nike, ExxonMobil, Citigroup, Shell, Nestle, and many other firms have suffered financial and reputation damages from boycotts against their operations. Even so, many companies have not incorporated sustainability risks into their ERM practices.

This paper proposes a new way to look at ERM by taking into account sustainability risks, which are very different from those found in most existing ERM frameworks. The paper is structured as following: Section 2 describes existing ERM frameworks. Section 3 discusses sustainability risks and opportunities. Section 4 explains a proposed ERM framework under sustainability platform. Section 5 addresses the role of board of director and senior management. Finally, section 6 discusses the conclusions.

2. Enterprise Risk Management Frameworks

When implementing an ERM process tailored to the company's needs, management should begin with a suitable framework as a point of reference.

There are different frameworks from which to choose: COSO ERM, ISO 31000 Risk Management—Principles and Guidelines on Implementation, BS 31100 Code of Practice for Risk Management, FERMA Risk Management Standard, and OCEG Red Book 2.0 (GRC Capability Model), and many others.

The most referred and widely used frameworks are the COSO ERM and ISO 31000. COSO ERM framework was issued in 2003 and revised in 2004. ISO 31000 was published in 2009. COSO ERM framework is not focused on specific activities of the risk management process, but rather provides flexibility in evaluating standard against which to evaluate the current ERM process. ISO 31000's emphasis is on providing guidance on risk management process and implementation, which broadens its appeal for those companies looking for insights on implementation of ERM. To this end, COSO has later issued a document of practical approaches and implementation guidance.

Implementing ERM is a journey because companies must evolve their strategy based on their experience on risks. Two frameworks are based on similar aspects of the risk management process. In practice, choosing a framework is often a matter of personal preference. COSO ERM framework is often selected because a company wants to leverage prior process using the COSO internal control framework due to the fact that COSO ERM framework incorporates internal control framework within it. The role of board members and senior executives in ERM process and implementation is as important as a suitable ERM framework. Furthermore, effective risk management requires an open and transparent risk culture, a balanced compensation structure, and policy of

actions taken when the warning signs are apparent.

The COSO defines ERM as a process affected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite to provide reasonable assurance regarding the achievement of entity objectives. ERM is equivalent to the ISO definition of risk management framework, which is a set of components that provide the foundations and organizational arrangements for designing, implementing, monitoring, reviewing and continually improving risk management throughout the organization. Such foundations include the policy, objectives, mandate, and commitment to manage risk.

By definitions, both frameworks do not seem to exclude potential sustainability risks. However, the COSO ERM framework focuses on the establishment of corporate objectives in strategic, operational, reporting, and compliance areas. The COSO ERM framework contemplates either interrelated components, which are internal environment, objective setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring. The ISO 31000 ERM Framework consists of seven components, which include mandate and commitment to ERM framework, risk management policy, integration of ERM in the organization, risk management process, communications and reporting, accountability, and monitoring, review and continuous improvement. The components in both frameworks are very similar and based on the very same concept, but sustainability is missing from all these components.

Although sustainability risks are often viewed as a primary concern for carbon producers and users of energy products but not for financial institutions, they have grown in significance for financial services companies. JP Morgan, a global bank, has acted to incorporate environmental and social risk management into its corporate lending and adopted the Equator principles for its project finance where total project capital costs exceed US$10 million. The development of equator principles is a result of a campaign against CitiBank for financing a project that included a clearing of rainforest. Equator principles is the only risk management framework developed by the World Bank for determining, assessing, and managing environmental and social risk in project finance, which is often used to fund the development and construction of major infrastructure and industrial projects. Financial institutions adopting equity principles commit to not providing loans to projects where the borrower will not or are unable to comply with their respective social and environmental policies and procedures. To date, there are 76 financial institutions in 32 countries officially adopted the equity principles, counted for over 70 percent of international project finance debt in emerging markets[1].

In addition, regulatory frameworks for both insurance and banking industries introduced requirement on operational risk to cover the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events, in which reputational damage is often considered a key consequence of operational failure. The fact that reputational risk caused by sustainability factors cannot be hedged or transferred; it can only be mitigated, makes sustainability risks become a central focus of operational risk management.

3. Sustainability Risks and Opportunities

Sustainability should be considered not only as an emerging area of risk, but also as an agenda of the firm's strategic management. Sustainability risks include social and environmental considerations, which are the two key components affecting both companies and society. Even though these two components are outside the scope of

[1] The Equity Principles Association, available online at: http://www.equator-principles.com/.

existing ERM frameworks, some companies report their sustainability concerns due to potential legal liability. As a result, only sustainability risks that could incur financial liability or reputational risk to the company are addressed under compliance risk based on COSO ERM framework even though environmental and social expectations can go beyond legal and compliance requirements. Some business transactions can create sustainability risk to the firm even when they are perfectly legal, especially transactions that involve different markets.

Another aspect of sustainability is that they are often viewed as a constraint for businesses. In fact, sustainability risks, like other types of risks, impose not only potential losses but also opportunities for businesses. ERM under sustainability platform can help improve environmental and social performance by holding down the costs of risk. Companies that can identify sustainability risks are equipped with useful data to reap opportunities through innovative product and process development, which can increase shareholders' value. In other words, sustainability can be an actual source of competitive advantage.

Shareholders are now more aware of exposures of the companies, in which they invest to sustainability risks, including climate and social change, depletion of nonrenewable resources, energy consumption, emission of greenhouse gases, and reputation damage due to related sustainability issues. Sustainable and responsible investing (SRI) is a broad-based approach to investing under the concept that your investments can result in a better world by building healthy communities, promoting economic equity, and fostering a clean environment. SRI now encompasses an estimated $3.07 trillion out of $25.2 trillion investment in the US investment market. SRI investors encourage companies to improve their practices on environmental, social, and governance issues. In the U.S., the number of SRI retail funds grew from 55 in 1995 to 493 in 2010[2], with the asset size grew from US$12 billion to US$569 billion. Of US$569 billion, about US$316 billion were SRI mutual funds, while the rest were exchange traded funds and closed end funds. SRI mutual funds perform as well as non-SRI funds over time. FTSE KLD 400, the longest running SRI index, has the return of 9.51 percent from its inception in 1990 through the end of 2009, compared with 8.66% for S&P 500 over the same period[3].

CERES launched the Global Reporting Initiative (GRI) in 1997 to the framework for corporate sustainability reporting. To date, there are more than 2,500 companies[4] worldwide voluntarily relying on the GRI to inform investors and the public about how the companies incorporate sustainability concerns in business operation. Information on how companies prepare to sustain in the changing environment are important for investors to evaluate the future prospects of companies.

Sustainability risk and opportunities have created an ongoing pressure for board of directors and senior executives to invest more resources in sustainability strategy. GE announced that the company would double its spending on energy and environmental technologies by 2015 to prepare for a huge global market for products that will help other companies and emerging countries meet their needs for clean energy sources. GE also committed to cut internal energy use by 30% and to reduce greenhouse gas emissions by 1%. PepsiCo has invested in sustainability risk management linked to water scarcity because water impact input costs, competitiveness, and the ability to maintain production. Its goal is to reduce water usage intensity by 20% between 2006 and 2015 across all manufacturing operations.

IBM has grasped that sustainability market trends can create a huge innovation opportunities for its business. The Green Sigma Industry Coalition was built by IBM to capture market opportunities linked to sustainability

[2] The Forum for Sustainable and Responsible Investment, SRI Facts, USSIF.org
[3] Bloomberg's Environmental, Social, and Governance (ESG) data service.
[4] Forbes, 6/19/2012.

trends from using IP networks to enhance urban development to deploying enterprise-wide software for energy efficiency programs. Siemens has also seek the opportunities linked to sustainability trends. In 2009, Siemens acquired Solel Solar System in response to a multi-billion dollar market for wind and solar power opened up in Europe, the United States, and China. Siemens' "environmental portfolio" was as large as US$31 billion in 2009.

Unilever, Nestle, and Procter & Gamble have been working on creating new markets and business models aligned with sustainability trends. Unilever launched the "Unilever Sustainable Living Plan" to increase the quality of life of employees, suppliers, customers, investors, and farmers, by integrating sustainability into its products. The plan can help the company save money by reducing energy, packaging, and waste, as well as make more revenue by creating new products for new markets where consumers and retailers prefer sustainable brands. An unwillingness or inability to compete in these new markets is not only the risk to shareholder value but also the risk for brand damage.

Today, primary lenders often require the firm applying for the loan to invest in an independent assessment of sustainability risks, which could lead to a recommendation for the company to enhance its ERM to include sustainability risks firm-wide and implement much stronger policies and reporting. Sustainability risks also include profitability risk from volatile energy and non-renewable resource price, compliance risk caused by new carbon regulations, and competitiveness risk from product substitution of sustainable alternatives.

It is clear that the pressure for a company to identify and manage sustainability risks come from every stakeholder; investors, customers, lenders, regulators, and even insurance companies. Swiss Re implemented a policy to exclude a company with certain economic activities leading to high sustainability risk from both insurance transactions and investments. These economic activities include the manufacturing of anti-personnel mines, verifiable complicity in systematic, repeated and severer human rights violations, infliction of repeated, severe and unmitigated damage to the environment, and proliferation of nuclear weapons. Swiss Re also has a policy to not directly underwrite risks or make investments into entities that are based in countries, which exhibits a particularly poor human rights record. As of August 2012, North Korea, Somalia, and Sudan are on Swiss Re exclusion country list.

Furthermore, sustainability ratings, measuring quality of sustainability risk management as a key component of managing total business risk, have become widely accepted as a reference for sustainability investing for investors. Companies with a good overall sustainability score will be listed in Dow Jones Sustainability Indexes (DJSI) or the FTSE4Good Index series.

4. ERM Framework under Sustainability Platform

Sustainability used to be considered a luxury concept for companies, and is still perceived that way for some, because environmental and social concerns are usually not counted in a traditional economic bottom line. Over the last two decades, the sustainability concept has gained more attention from executives, investors, lenders, and regulators. However, sustainability risks are still not included in most existing ERM frameworks even though global public expectations have emerged that companies should behave responsibly and accountably in terms of minimizing their environmental and social impacts irrespective of whether the relevant local laws and regulation are weak, strong, or not properly enforced. Therefore, an emerging area of sustainability risks should not be ignored from ERM frameworks designed for either manufacturing companies or financial institutions.

Sustainability platform can give the risk manager a broader view of risks, which provide better information

to make better and longer-term solutions. This paper proposes a new ERM framework under sustainability platform that can have universal appeal for all industries. The proposed framework includes 6 components: sustainability vision, sustainability strategy, ERM process, implementation, reporting, and ERM enhancement.

(1) ERM and sustainability vision

The shift toward greater expectation for effective ERM and sustainability management is complicated by the fact that the volume and complexities of risks affecting the company are increasing. The sophistication of business transactions, the explosion of globalization, rapid changes in information technologies, increased competition, and greater demand for transparency and accountability on a company non-financial impacts, make it more difficult for boards and senior executives to effectively oversee the constantly evolving complex portfolio of risk. In response to these changing trends, the companies are embracing ERM and sustainability concepts because they emphasize a top-down, holistic approach to effect risk management for the entire company.

The first and most important step is to come up with a vision for the company to address its willingness and intention to identify and manage enterprise risk under sustainability platform. The ultimate outcome should be a company that is fully aware of, and does consciously manage and account for, the sustainability impacts of its business transactions to ensure that the inherent conflict between growth targets and sustainability goals is handled in an appropriate manner.

The challenge, as well as opportunity, for the firm is to embed risk and sustainability thinking and ERM under sustainability platform explicitly into the vision and strategy of the firm so that the vision, strategy, and risk mindsets are one in the same. The goal of ERM under sustainability platform is to increase the likelihood that a company will achieve its objectives by managing risks to be within the stakeholders' risk appetite while minimizing environmental or social impacts in all business transactions.

(2) Sustainability strategy

To include sustainability in the firm's strategic management, the awareness of sustainability risks in all business transactions from daily operations to investment decisions is required. A broad-based educational program on sustainability risks should be conducted throughout the organization, across all functions and levels. The strategy should be clear in demonstrating to the business and functional unit leaders as well as their management teams the importance of considering the impact of sustainability risks within their actions and decision-making.

The company must review the context in which it operates, starting with the external context that includes market conditions, competition, technology trends, legislative requirements, weather and climate impacts, country risks, political environment, globalization factors, key drivers of profitability and sustainability, including financing and other resources, external stakeholders' needs issues and concerns, and any other factors that influence threats or opportunities and their associated risks. The internal context should include the complexity of the company in terms of size, number of locations, number of countries, degree of vertical integration, existing regulatory and legal requirements, key internal drivers of the company, the objective of the company, existing strategies and organizational structure of the company, and any other internal factors that will impact ERM and sustainability of the company. The combination of above external and internal contexts can help the company to set a suitable ERM strategy under sustainability platform.

Gap analysis of existing ERM framework against a proposed ERM under sustainability platform can provide a baseline for the design of the framework as well as to confirm potential benefits. The gap analysis can be complicated by the existence in organizations of several existing risk management activities each with its own

unique terminology and processes. For the ERM under sustainability platform to integrate and incorporate existing activities, it is necessary to specify some basic principles, standard terminology, and a method of translating them into a common risk management process.

(3) ERM process under sustainability platform

The ERM process under sustainability platform should comprise risk identification, risk assessment, and risk response strategy. ERM process should include sustainability risks of the greatest interest to customers, investors and key stakeholders. Sustainability risks must be identified, managed, and monitored, in addition to other types of risks. This proposed ERM framework under sustainability platform suggests four main risk categories shown in Figure 1, which includes sustainability risk, financial risk, operational risk, and strategic risk. Sustainability risks cover the emerging areas of risks for business like environmental, social, and ethical issues. Financial risks can be subdivided into credit risk, market risk, and liquidity risk. Similar to Basel definition, operational risks cover potential loss from human, system, internal process, or external events. Finally, strategic risks include potential loss from changes in economic landscape, technology innovation, competitiveness, and globalization.

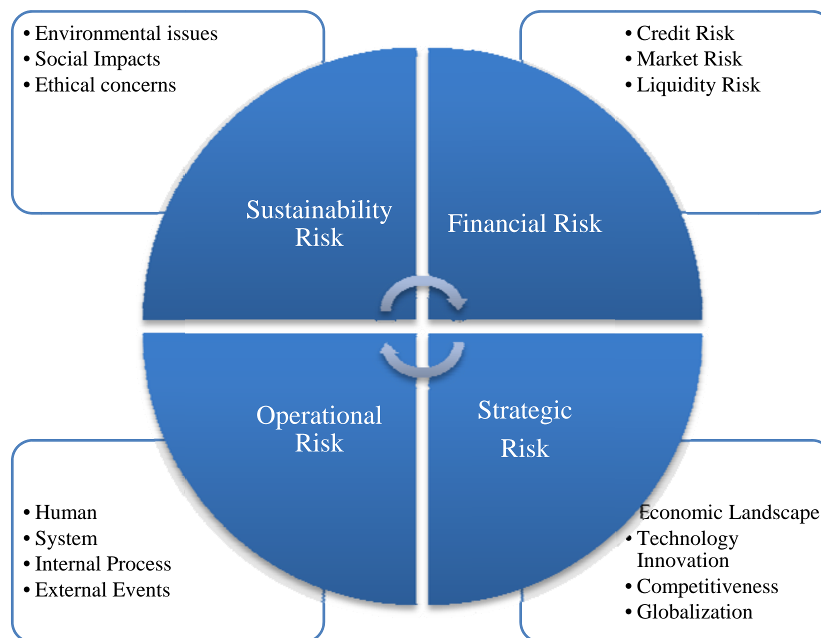

Figure 1　Four Risk Categories for ERM Framework under Sustainability Platform

The identification of sustainability risk can be supplemented by a media survey to help identify the environmental, social, and ethical issues that occupy the public. Another useful source for identification of sustainability risks is from the NGOs who can provide the company with early warning of new sustainability issues. Moreover, it is also helpful for the company to dialogue with the NGOs to develop appropriate risk response strategy.

Risk assessment can provide decision makers with sufficient understanding of the risk to be able to make the decisions on risk tolerance level and appropriate risk response strategy. The basic idea is to evaluate each risk from two dimensions; frequency and severity, to identify areas of vulnerabilities or opportunities. Risk assessment process can be a combination of quantitative and qualitative methods depending on the amount of available data and risk types.

Risk response strategy include both control and non-control options. Cost and benefit analysis of each option should be conducted to select the best treatment for each risk. The selected risk response strategy should include identified risk owner and be in line with board level risk appetite and risk tolerance. In order to define the risk appetite for sustainability concerns, we need to determine what is at stake when a sustainability challenge negatively affects stakeholder perceptions and become clear on the practical implications of the core values of the company. It is also worth trying to attach a monetary value to the integrity of corporate principles and values. This value can be estimated by calculating the amount of possibly foregone business. The other more difficult task is to quantify the value of stakeholder trust and reputation where no one universally applicable approach exists. This understanding is the basis for the subsequent development of a group-wide policy on managing environmental, social and ethical aspects in business transactions. Finally, the reputation risk stems from a perceived lack of integrity that cannot be hedged, diversified, or transferred. It can only be managed by reducing exposure to sustainability risks in individual transactions.

(4) Implementation

Implementation is the most difficult step that requires active roles of board of directors, senior executives, risk owners, and operating staffs. Key to an effective ERM implementation in business transactions is that the ownership for the framework is clearly defined and embedded in the overall ERM system. This includes the assignment of responsibility for identifying the relevant sustainability topics, assessing their potential impact on the company, and the development and maintenance of principles and implementation guidelines. More importantly, escalation procedures need to be in place should conflicts between business and risk management interests arise. Business decisions, which could potentially have a significant impact beyond the local entity, but for which no tolerance level has been defined centrally, would need to be escalated to the company's headquarters for ultimate decision-making.

There are limitations to the implementation of transaction-related sustainability risk management across an entire company. Under certain circumstances, sustainability risks either are not identified or not addressed in certain transactions because the company cannot be held responsible for environmental and social impacts of every entity over which they may have some influence but was not a causal agent, direct or indirect, of the harm in question. However, such decisions should be stated explicitly and agreed upon by both risk and transaction management.

(5) ERM reporting

ERM reporting is important for the purpose of monitoring and reviewing. It is a key to the continuous improvement of ERM system. The information needed in ERM reporting includes changes in risk trends and risk contexts as well as effectiveness of ERM implementation and risk control activities. The information must be able to relate to the existence, nature, form, likelihood, severity, evaluation, acceptability, treatment, or other aspects of risk management. The frequency of ERM reporting should be in line with board decision on the frequency of monitoring. Each outcome in ERM report can come from internal audit, third party, or self-assessment, depending on internal work process of each company.

The responsibilities and channels for risk reporting and the role of risk owners as to what information they should provide about their operations, decisions, and risks, must be clearly identified. These responsibilities usually include reporting about both the risk and the risk control activities on a periodic basis. ERM reporting can utilize key risk indicators for risk monitoring. It is very important to specify ERM reporting during crisis situations and the execution of business contingency plans after a crisis. For sustainability risks, ERM reporting

should go beyond internal communication. External communication to all stakeholders outside the company is very crucial in mitigating sustainability risks.

(6) ERM enhancement

Similar to a company's strategy, ERM framework must evolve with changes in market environment and pressures. The enhancement of ERM framework can be achieved through continual improvement of risk management through the setting of organizational performance goals, measurement, review, and the subsequent modification of the processes, system, resources, capability, and skills. Effective external and internal ERM reporting and communication are essential for ERM enhancement. Comprehensive and frequent internal and external reporting on both key risks and on risk management outcomes contributes substantially to effective governance within the company as well as trust by stakeholders.

5. Role of Board of Directors and Senior Management

ERM under sustainability platform should be fully integrated into the management of the company. The integration requires a mandate and commitment from the board and senior management. Although executive attitudes towards sustainability are gradually improving, some still consider sustainability as a cost to the company instead of a source for market opportunity and long-term value creation. Sustainability risks and opportunities pressure executives from multiple sectors to develop a vision for sustainable business and invest in the plan to mitigate sustainability risks and capture market opportunities.

Generally, boards of directors should provide oversight and accountability for corporate ERM and sustainability strategy. Within each company, senior executives should be held responsible for achieving ERM and sustainability goals. For larger companies, the CEO should appoint one senior executive, Chief Risk Officer (CRO), to oversee ERM system, and another senior executive, Chief Sustainability Officer (CSO), to coordinate sustainability efforts. CSO can be effective in integrating sustainability into strategy, planning, and operations. These roles should also be identified in corporate communications in order to encourage personal accountability for sustainability endeavors.

For ERM and sustainability to be effectively implemented, senior executive performance and compensation packages should be linked to ERM and sustainability performance within a company. This leads to increased accountability and positive impacts on organizational culture. To ensure sustainability strategies are executed, companies should integrate them into corporate policies and risk management systems. With respect to risk management systems, companies should incorporate environmental and social risks and opportunities into their business processes. This allows companies to identify events relating to sustainability that are relevant to their business objectives and assess the magnitude of their impact. The boards and executives are also expected to be involved in the development of the company's public policy positions. This expectation calls for transparency and encourages companies to develop best practices for sustainability that are consistent with their social and environmental goals. Corporate board members are obliged to address risks, which include the financial impact of climate regulation and the scarcity of resources. The companies that embrace strong governance will be better positioned to foresee and adapt to changing economic, social, environmental, and political conditions, allowing them to better manage their risks to maximize shareholders' value.

6. Conclusion

Given the increased demand and intensifying scrutiny for greater transparency and accountability on a company's non-financial impacts, every company can no longer safely ignore long-term economic issues, environmental impacts, and social responsibility. A systematic way of handling those environmental, social or ethical issues that occupy our key stakeholders is to incorporate them into ERM system of the company.

This paper proposes a framework for ERM under sustainability platform to assist a company in the first step to becoming more aware of their indirect impacts of sustainability risks and to provide guidance with respect to handling them. There are 6 components in the proposed framework: sustainability vision, sustainability strategy, ERM process under sustainability platform, implementation, reporting, and ERM enhancement.

The most important factor for ERM framework under sustainability platform is active roles of board of directors and senior executives. This paper discusses how and to what extent the board, in concert with senior management, can establish the appropriate "tone from the top" to ensure that ERM system under sustainability platform remain at the forefront of strategic and operating decisions made within the business.

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"Are Initial Public Offerings a License to Steal from the Unsophisticated Investor?"—An Analysis of the Facebook IPO Debacle and the Class Action Lawsuit…

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Abstract: Wall Street recognizes one size only….extra large….when it comes to earnings, profits, growth and Initial Public Offerings. Perhaps that is what initially attracted the unsophisticated investors in unprecedented numbers to the Facebook IPO. Ironically, the unknowing investors' confidence was immediately shaken when the shares failed to meet projected price targets and, the stock actually tumbles instead of rises. The deceptive valuation and pricing practices, that are rampant in the IPO and investment analysts' arena, was successfully orchestrated during the road show that Facebook insiders participated in just prior to the May 2012 stock debut. The tale as told by the Facebook insiders just prior to the IPO stock sale at $38 per share appears to be a fairy tale and is currently the subject of an SEC investigation. Wall Street unfortunately has a very short memory. History is continually repeating itself as the lessons learned from corporate fraud and malfeasance is immediately forgotten whenever opportunity for new wealth arises. Is it greed, ignorance or inflated egos that continually drive the desire of investors to buy an IPO at any price regardless of the long-term consequences?
Key words: IPO; social media; financial statements
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1. Introduction

The company known as Facebook or "FB" to Wall Street aficionados, has attracted youthful users, financial trendsetters, creative advertisers and mainstream America because of the dream come true story behind the founder of the company. A college student, who created a multi-billion dollar company inside a dorm room at Harvard, becomes an overnight success story. Yes, it is apparent, dreams do come true and every investor wanted to grab a piece of the magical dream when the opportunity was made available on May 18, 2012 at $38 per share. But why did so many people want to buy Facebook or FB as it is now known? Were these investors aware of how the $38 IPO price was set? Would these investors have been as anxious to buy the stock if they were informed of a

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potential problem with the future estimated sales growth projections? Was the proverbial wool pulled over the eyes of the naive investor by a wolf in sheep's clothing by the name of Mark Zuckerberg? Could the dream of becoming a millionaire by investing in FB be, in reality, does the elite of Wall Street perpetrate a fraud on the unsophisticated investors?

The lurid headlines of the past few years highlighting the avalanche of hearings, lawsuits, arrests, and trials has created an aura of suspicion focusing on the "fictitious" reporting of financial value should have served as a warning to the eager investors anxious to buy the FB IPO. Wall Street, major corporations and the media are all major players in this deceptive practice of creating value where in reality there is none.

2. Is There a Problem with Social Media IPOS?

The consequences of earnings manipulation and irresponsible financial reporting and the resulting impact on the accounting profession and the economy through IPO debacles has eroded the already problematic reputations of the public accounting elite. Firms like Ernest & Young and Deloitte have been linked unfavorably with recent questionable earnings projections of some newly minted IPO's (McKenna, 2012). The concept of manipulated earnings is currently seen as a "fait accompli" by the sophisticated investing community but not to the unsuspecting unsophisticated investor.

The FASB has wrestled with the issue pertaining to revenue recognition of social media companies and has chosen to rely on SAB 101 as the fallback strategy (Chittum, 2012). Rather than design new revenue recognition rules aimed at the social media industry they have in essence abdicated their role and assigned the job to the "biased" management of the companies in question. The accounting profession has acknowledged the complexities involved in accurately pinpointing the exact timing of when social media earnings are earned in accordance with Generally Accepted Accounting Principles or GAAP and therefore uncertainty remains the prevailing mindset. The fact that reliable earnings recognition, a premise that is one of the most essential fundamentals of accurate financial statement reporting is of great concern to the social media reporting process further complicates the IPO valuation process.

In essence, the primary source of value for social media companies like Facebook, Zynga and Linkedin is future revenue streams (Borchardt, 2012). These companies balance sheet lack any real value other than cash and retained earnings or profits. Add to the mix ambiguous assets like goodwill and you have a valuation nightmare.

Ironically, the independent auditors are not asked to issue an opinion on the IPO stock valuation, a step in the IPO process that one would think would be a requirement to assure fair reporting standards. The primary reason why the independent auditors fail to express an opinion on the fairness of the IPO's price is because it is not based upon reported financial statement numbers, but rather projections of future earnings, which the auditing profession accurately recognizes as impossible to render an opinion upon. So what do investors of IPO stock really look for when deciding whether the IPO price is fair? It appears they rely on the "horse and pony show" created by public relations experts rather than the information presented in the voluminous registration statements.

A further indication of the problematic IPO situation is the fact that foreign companies are now attempting to have as many of their IPO's issued in the United States because of the perceived lack of regulation by the governing bodies (Davidoff, 2012). The international investment community is increasingly aware that the American IPO market is where you file if you want to avoid regulation (Davidoff, 2012).

The attraction to a US IPO debut, in part, is related to the opportunity to issue dual-class voting stock, which the SEC allows and many international markets do not. Additionally, international companies do not need to comply with US based GAAP rules, viewed to be more restrictive than the international reporting standards (Davidoff, 2012). The overwhelming amount of failed international IPO's in recent years is serving to undermine the credibility in the international investment community leading many astute investors to conclude the American IPO system is as flawed as their foreign counterparts.

This premise is clearly evidenced by the erosion of confidence in Chinese emerging growth companies introduced on the US based IPO market after their admissions of *accounting problems* in their reports (Moscovitz, 2012). Unfortunately, over 93% of the value of these same companies, have fallen since their IPO debut (Moscovitz, 2012).

3. The Problem with the IPO Pricing Model

There are three major problems associated with fairly pricing an IPO for price (Moscovitz, 2012):

(1) Revenue recognition issues and forecasted earnings

(2) Lack of an Internal Control Effectiveness opinion

(3) Lack of Independence of the Auditor

Perhaps the reason potential investors fail to analyze the prospectuses of IPO's prior to acquiring their stock is because the process is akin to a required school's summer reading list with War and Peace and The Odyssey as the only selections. The process is both time consuming and boring. Instead the investors chose to rely on the hype for their sources of reliable information, much to their chagrin of late.

The FB prospectus is replete with all sorts of numbers, which tell a completely different story from the headlines in the financial papers. FB had earnings per share or EPS of 47 cents (vs. 28 cents in 2010) and a book value of $2.00 per share (Fidelity, 2012). Whether these numbers support a $38.00 IPO price is questionable at best. In addition to the disappointing numbers the quality of the balance sheet assets are disturbing as well. FB's primary asset is CASH, they have very little other assets, which leads one to conclude the FB financial structure has a weak foundation. There is very little debt, but without assets that have the potential to create future value for the stockholders, what in essence are stockholders buying?

Issue 1: Future revenue recognition as a primary valuation guide

Future revenue streams coupled with prior reported earnings appears to be the pricing model in place for the social media IPO stock valuation process (Pepitone, 2012). That idea would be only slightly acceptable if it were not for the fact that the future s impossible to predict. That fact is clearly illustrated by the fact that a major revenue provider, General Motors, cancelled their multi-million dollar advertising contract just prior to the FB IPO debut (Armstrong, 2012). This reminds us of the old cautionary tale of "don't count your chickens before they hatch."

Apparently, the social media IPO pricing model has chosen to ignore that time honored adage. Additionally, some FB insiders were concerned that the projected revenue stream could fall short of expectations, thus damaging the FB IPO pricing strategy (McKenna, 2012).

Whether FB's $38 initial public offering price was fair remains to be seen, but the process in which it was established is rife with problems (Chambers, 2012). If the value of the IPO stock's debut price is based upon questionable historic earnings in light of the revenue recognition issues and, future revenues, which are impossible

to verify, the pricing model of social media IPO stock issues are doomed for failure (Leone, 2009).

Issue 2: Effectiveness of internal control not addressed

The prospectus should be the primary source of reliable financial information pertaining to an IPO. As these companies were private prior to their IPO debut, the prospectus is the first time the company was mandated to comply with the Securities and Exchange Commissions or SEC requirements pertaining to publically traded securities (Armstrong, 2012). The SEC requires that all public companies issue an annual report that includes all the financial statements, the GAAP methods applied in the notes, an opinion on the effectiveness of the internal controls (both management and auditor) and most importantly, an opinion from an independent auditor on the fairness of the financial statements included in the report. Ironically, the requirements for the IPO do not include all the requirements of an already public company (McKenna, 2012).

For example, the prospectus does not include an opinion on the effectiveness of the internal control, in other words known weaknesses in IPO's internal control systems are not reported (McKenna, 2012). Companies would not be required to disclose said weaknesses until their first quarterly filing with the SEC filing the IPO's debut. This is extremely disconcerting given the problems associated with Enron and their ineffective internal control issues which ultimately culminated in the 2002 Sarbanes-Oxley legislation (Leone, 2009).

Newly minted IPO companies being exempt from this requirement undermines the entire reporting process for the entire valuation procedure. Ineffective or weaknesses in an internal control system have been historically linked to fraud, financial statement reporting errors and undermines the credibility of the entire reporting process. Private companies, previously exempt from the internal control scrutiny process, should be required to inform the investment industry of known weaknesses prior to the issuance of the stock in order to provide the adequate disclosure mandate for all publically traded companies.

Once a private company enters the public arena, they should be required to abide by the same rules established by the SEC to ensure the investing community, are, fully informed. If auditors of publically traded companies are required to issue an opinion on the effectiveness of the internal control system of the company in question, that same requirement should be in place for the IPO valuation process (Leone, 2009).

Issue 3: Lack of independence of the auditor

Independence of the auditor is another issue undermining the credibility of the IPO prospectus reporting process. Prior to the introduction of the shares, public accounting firms are not held to the same rules as the public auditor pertaining to independence. The privately held company can have the same accounting firm provide both management advisory services and auditing, a once sanctioned practice has now become akin to a criminal offense as a result of the Enron-Arthur Andersen debacle of the 2000's (McKenna, 2011). Publically traded companies are no longer allowed to have the same accounting firm provide both management advisory and auditing services as they have been deemed to be in conflict of one another and in essence erodes the independence factor so tantamount to the value of the auditors opinion. If this requirement is in place for publically traded companies, the same requirement should be established for the pre-IPO process. If an accounting firm has in essence guided the private company toward their goal of public, they should be prevented from issuing the financial statement opinion for the same reason: lack of independence (McKenna, 2012).

Apparently, this issue, has been a focal point of discussion, pertaining to the IPO valuation problems of Zynga, Groupon and most recently Facebook and the role Ernest & Young played in the pre and post IPO process (McKenna, 2012). The lack of independence of the provider of financial reporting is at issue at all times as the

responsibility for the financial statements rests with a biased party, the management team. The independent auditor’s opinion is required to mitigate the known biases of the reports. If IPO’s are permitted to circumvent the reporting process rules mandated to correct weaknesses in the auditing process, the prospectus cannot be viewed as a legitimate financial report.

4. The Truth after the IPO Debut

Interestingly, many companies are forced to in essence “fess up” to the truth about the financial statements only *after* their companies have gone public. Groupon’s management admitted in December 2011, that their internal controls were not effective due to materially weaknesses in their system (Moscovitz, 2012). Additionally, the company issued revised earnings for the fourth quarter of 2011 in March 2012. This revelation will not be classified as a restatement of earnings because as an IPO, Groupon had not filed financial statements with the SEC prior to the announcement, only a prospectus. The fourth quarter disclosures made by Groupon were deemed pro forma disclosures and therefore not subject to the rigors of GAAP as applied to a public entity. What is so problematic about both of these issues is that Ernst & Young, the company’s auditor, never disclosed the information to the stakeholder’s because of the inconsistency in the reporting requirements for a public company vs. an IPO. The role of the public accountant is murky at best given these conditions.

The Ernst & Young auditors may not have had a legal obligation to report the major deficiencies in Groupon’s Internal Controls, but most would argue they had a moral obligation to disclosed that information. Additionally, Groupon’s Management Discussion and Analysis Section, or MD&A, should have included a reference to the major weaknesses.

Groupon, known by their trading symbol GRPN, debuted on November 4, 2011 at $20.00 per share and closed at $26.00 at the end of the first day of trading. The stock had risen as high as $31.14 but is currently trading near its low of $8.52. The cause of the wild fluctuations are in part, due, to the disturbing revelation that Groupon had seriously underfunded their coupon reserve causing materially misstated earnings for the 4th quarter 2011. That revelation resulted in a $42.7 million loss to morph into a $506.5 million loss. Additionally, Groupon has been on a buying spree acquiring a total of 17 companies, which accounts for any sales growth not being internally generated growth, but merely growth by acquisition. Furthermore, Groupon reported EPS of ($1.40) and a matching deficit in retained earnings of ($698,704) in December 2011 compared to ($419,468) in 2010. The 73% decline in the stock valuation from the $20.00 IPO to the current $8.52 value is better understood in relation to the disappointing financial statement numbers. How the $20.00 IPO price was established is clearly problematic and this issue is made more apparent by the on-going class action suit filed pertaining to alleged violations of the Federal Securities Regulations.

Another IPO disaster, Zynga, debuted on the IPO debutants ball in 2011 at a $10.00 price and quickly fell to the $5 dollar range, where it currently trades in July 2012. As in the case of the other IPO companies, the financial statements reveal a story far different from the tale spun on the IPO stock selling tour. Zygna has a reported deficit in retained earnings of ($394.09) for 2011, an issue obviously not highlighted during the stock promotion tour.

The only IPO that appears to have been successful in the social media group is Linkedin. The stock debuted in May 2011 at $45.00 and quickly rose to $94.00 by the close of the first day of trading. Linkedin has managed to maintain that inflated value, currently trading at $104.52 in July 2012. Interestingly, an analysis of the financial

statements reveal that Linkedin reported an 11 cent EPS in 2011 compared to 17 cents in 2010 and a book value of $5.96 at December 31, 2011. Whether these numbers support the current stock price remains to be seen.

5. The Case for a Class Action Lawsuit

A law called Regulation and Fair Disclosure requires that publically traded companies release information to all investors at the same time, and as such, prohibits insider trading or trading based on an insider's advantage (Pritchard, 2012). Ironically, the same rule does NOT apply to a company in the process of introducing their company for an IPO sale. Technically, the IPO Company is a privately held company prior to the sale of the securities, and as such, does not need to abide by the same law. The rule guiding IPO's is disclosure of information pertaining to the prospectus of the company. The guideline establishes that a company may not present information to potential investors that are in conflict with the information as presented in the prospectus. But, ironically, oral communication is not covered by that requirement so any IPO management team can say whatever they want orally without fear of a lawsuit (Chittum, 2012).

In the case of the most recent IPO debacle, Facebook has been the target of over 40 lawsuits stemming from the May 18, 2012 stock debut (Pepitone, 2012). The issues are complex and range from problems with a "technical error" on the Nasdaq Exchange to an assertion that a privileged group of Facebook insiders were privy to the selective disclosure of problematic financial information not made available to everyone (Pepitone, 2012). The selective disclosure assertion states that a problematic outlook was disclosed to "big banks" ahead of the IPO debut (Pepitone, 2012). The lawsuit claims that issues relating to FB's mobile revenue problems were discussed with a select group of insiders and that FB updated their prospectus concerning these issues in a less than straightforward manner for the rest of the public. In response, FB has emphatically denied any wrongdoing claiming that "there wasn't any desire to obfuscate or hide information" (Pepitone, 2012).

Additionally, a securities fraud lawsuit filed in New York alleges that even though Facebook's prospectus included 23 pages of risk factors, the complaint alleges that the company made misleading statements and omitted material facts (Greenwald, 2012). The fraud lawsuit asserts further that the Facebook IPO documents were not prepared in accordance with Federal rules and regulations governing their preparation and as such violated Federal Securities Laws (Greenwald, 2012). Furthermore, lawsuits have been threatened relating to the last minute increase in the number of shares in the offering, which in essence tripled the size of the issue at virtually the last moment. The fact that Facebook insiders failed to widely disclose their projections for greatly reduced earnings in 2012 is their biggest problem because it goes to the heart of transparency which undermines their defense in the court of public opinion (Greenwald, 2012). The shareholders of Groupon have filed a similar suit alleging Federal Securities law violations citing similar financial statement distortions.

The FB lawsuit alleges that certain documents filed with the SEC prior to the IPO offering lacked the necessary relevant information required pertaining to revenue forecasts (Gilman, 2012). The primary area of concern related to the realization that a severe and pronounced reduction in revenue growth, due to an increase of Facebook users' adoption of mobile devices to access information in place of the traditional PC process, was problematic to FB's future revenue growth.

6. Conclusion

The Initial Public Offering market is viewed by many naive investors as an opportunity for dreams to come true. The dream of buying the IPO and having the stock become the next Federal Express or Apple Computer looms large in many investors thought process. The reality of the IPO story tells a far different tale. Most of the recent social media IPO’s have been viewed as a nightmare instead of a dream come true. Falling prices, restated earnings, inflated sales projections and problematic internal control systems provide the truth behind the distorted picture painted by the insiders of the IPO story line. Investors should be aware of the cautionary tale told by the Facebook, Zygna and Groupon IPO debacles and look for less risky venues to provide them with their fairy tale endings. Perhaps a trip to Las Vegas is a better route, at least the odds are only 51% for the house and no one knows the odds when betting on an IPO.

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CEO Succession in the Emerging Markets: Political Ties, Institutions and Networks

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Abstract: Drawing on the resource based view and network perspective, this paper explains how firm manage their political resources over time under the condition of different geographical institutions and inter-organizational networks. Firms obtain political resources through managers' personal connections, and in the dynamic environment, such resources evolve in the life cycles. However, the value of political ties decreases when firms access more learning opportunities in inter-organizational networks and with geographical institutions well developed. We test this effect in CEO turnovers by using data from China listed firms in 2008 and compare the contextual roles of political resource in affecting CEO dismissals. The contributions are due to a synthesis of institutional and ecological perspectives and to research on CEO succession in emerging market and organization learning in networks.

Key words: political resource; CEO dismissal; dynamic RBV; networks, institutions
JEL code: M51

1. Introduction

Resource based view is one of the most prominent theoretical perspectives in strategic management (Wernerfelt, 1984; Barney, 1991; Teece et al., 1997). The central argument of this perspective is that heterogeneity in resource and capabilities makes firms different in competitive positions. Resources may refer to all the tangible or intangible assets that an organization owns, controls, or has access to (Wernerfelt, 1984), and capabilities may refer to firms' abilities to utilize resources, and perform a set of tasks to gain intended results.

Barney (1991) argues firms achieve competitive advantage when they implement value- creating strategies which the competing firms are not engaging in. However, competitive position of firms may shift over time due to the evolution of resources and capabilities, and the dynamic capabilities have attracted increasing attention (Teece et al., 1997; Zollo and Winter, 2002). Such evidence suggests the use of evolutionary economics to enhance the resource based view (Bromiley and Fleming, 2002). For instance, Helfat and Peteraf (2003) studied the evolutionary patterns and paths of capabilities from the perspective of capability lifecycle. In dynamic resource based view, it is debated that competitive advantages are becoming more temporary because of environmental uncertainty (Miller, 1993; Lewis and Harvey, 2001), and the firms' capabilities should be renewed, improved and updated simultaneously. Therefore, it is necessary to investigate the evolution of resources and capabilities in dynamic settings.

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Social embeddedness has long been argued to be crucial (Granovetter, 1973). In various settings, individuals, groups, or firms could use their social networks to gain favorable results (Moran, 2005; Walter, Lechner, and Kellermanns, 2007). Along with resource based view, social capital refers to actual and potential resources embedded in the relationships of individuals, communities, networks, or societies (Nahapiet and Ghoshal, 1998).

In management, social capital is important for the performance and behavior of firms. It is generally believed that the social capital can be utilized to enhance the effectiveness of firms (Nahapiet and Ghoshal, 1998). In sociology, social capital benefits actors themselves who have social ties (Burt, 1992). The different levels of social capital could interact with each other, and this enables a mechanism that the individual's social capital transfers to the organization. However, previous work has not paid sufficient attention to this mechanism. In this paper, I argue that managers' personal social network could be absorbed and utilized by the firms, and inter-level transformation could influence the recruitment and dismissal of managers.

The purpose of my paper is to study the trajectory of resource and capabilities from a dynamic perspective. Especially, the government plays a role to foster cooperation among local organizations and provide both institutional and resource supports for firms. So I focus on firms' capability lifecycle to obtain, use, and update political resource which is originally introduced though managers' personal social ties. The primary research questions addressed in this article are: Does firms' political resource change or persist over time? How do firms develop capabilities to exploit managers' social capital? How do the political connections affect firms' decision on the recruitment and dismissal of manager? Do the effects above vary across different cultures and market environments? These questions are important both managerially and theoretically and will be addressed through the formulation of hypotheses and via a novel empirical study.

This article contributes in three important ways. First, I extend resource-based theory into new application of social capital by identifying an important role of political resource from a dynamic perspective that has not been fully specified previously. I find that, in managing political resources, firms' capability evolve from the exploitation of current political resources to exploration of the new ones. Firms will posit itself in different stages of the capability lifecycle, and they need to update and renew their political connections under the uncertainty during the financial crisis. Second, I argue that the social capital of individual level could be utilized by and then transferred to the organization. Firms which get political resources via managers' personal network will develop new relationship of organizational level which could substitute the managers' personal ties. And this will devalue the political connected managers, making them dismissed and succeeded by managers with new and valuable political connections. Third, I examined my assertions in the context of both emerging and developed economies. I found contingent results for political resources and capabilities to evolve over time in the contexts of China. In this way, my paper echoes Lin and Si's (2010) call for comparative examination of the dynamics of social capital in China and other developing or underdeveloped countries.

The current paper begins by deriving a review of the previous literature as well as the core arguments regarding social capital, and dynamic resource based view. In the discussion that follows, I lay out the hypotheses and elaborate on these ideas to build an integrated research framework. Then I use the data from Chinese listed firms to test all the hypotheses and achieve the empirical results. Finally, I make conclusions and give suggestions for the future research.

2. Theory and Hypotheses

2.1 Social Capital as Valuable Resource

In the strategy literature, RBV provides an explanation of competitive heterogeneity based on heterogeneous resources and capabilities (Peteraf, 1993; Hoopes et al., 2003). In this view, firms are bundles of resources which include the physical capital, human capital, organizational capital and social capital that enable firms to achieve strategic goals (Barney, 1991). The socially embedded relations are critical resources for social actions (Burt, 1992). According to Maurer and Ebers (2006), social capital "signifies an asset available to individual or collective actors that draws on these actors' positions in a social network and/or the content of these actors' social relations". As a type of rather intangible asset, social capital provides access to information, resources, technology, markets and other resources through social network.

In the tradition of public choice theory, government expose exerts intervention on firms for the purpose of rent seeking, extraction, and protection (McChesney, 1987; Shleifer and Vishny, 1998). So firms take efforts to use the power of government to benefit themselves through the engagement in policy-making and the connection to the government. The capability to build network of external relationships with government can increase social capital and thereby gain interests in the form of superior access to information, power and solidarity.

Previous research has noticed that social capital can be related to the important factors as turnover rates (Krackhardt and Hanson, 1993) and career success (Gabbay and Zuckerman, 1998). As a special form of social capital, political ties could affect firms' decision on the recruitment, selection and dismissal of top managers. Managers with political ties are attractive to firms, and this advantage makes them the potential competitors for CEO position in a firm. After a firm hires a new CEO with political ties, the firm begins to create, maintain and develop relationships with government via the CEO's personal networks, and further utilizes the valuable resources embedded in these relationships. In summary, I argue that candidates who have political ties are more likely to increase the hazard the current CEOs' dismissal.

The existing literature on CEO dismissal has suggested that poor firm performance and political reasons are two major factors for CEO dismissals (Fredrickson et al., 1988; Ocasio, 1994; Shen and Cannella, 2002). While organizations are ruled by political elites, or dominant coalitions these "... elites do not last. The history of man is the history of the continuous replacement of certain elites: as one ascends, another declines" (Pareto, 1968). So CEOs might not able to perpetuate their power even though they maintain certain kinds of political ties before. Instead, as the organization faces change in its environment, executive capabilities will be questioned, rivals and enemies will emerge, and the likelihood is greater so that those in position of power will lose their power (Pfeffer, 1992), especially when the firm is seeking for new political ties to undermine uncertainty. Based on the above arguments, I posit the following hypothesis.

Hypothesis 1: The political connections of successor increase the hazard rates of incumbent CEOs' dismissal.

2.2 Moderation of Inter-organizational Networks and Geographical Institutions

The social capital of individual-level and organizational-level often interweaves together. Personal ties can be a driving force behind resources obtained from inter-organizational networks where the relationships depend on specific individuals (Dyer and Singh, 1998). The firms could develop capability to utilize the individuals' personal social resource in the transformation of relationships at the personal level into relationships at the organizational level. In this way, individuals' social ties could grant firms access to valuable resources and information, so individuals draw on social capital to perform their jobs (Burt, 1992). Particularly, top managers play an essential

role in the corporate strategy (Finkelstein and Hambrick, 1996). They not only contribute human capital such as education and experience (Coleman, 1988), but also provide social capital which represents the top managers' relationships with organizational members and other actors outside (Geletkanycz and Hambrick, 1997).

Besides the political ties, there might be some other ways for firms to access resources and learn valuable knowledge. Since the mid-1980s strategic alliances and networks have been paid increasing attention by strategic management scholars. In the organizational behavior field, the topics of organizational learning and the learning organization have similarly become major foci of attention. More recently, there has developed an emergent literature concerning learning in networks and between organizations.

By interact with each other in networks, organizations share information and other resources. In what is becoming known as the "knowledge-based-view of the firm", knowledge is seen as the resource on which firms base their competitive advantage. Participating into the inter-organizational networks, the knowledge could be transferred more effectively and efficiently through individual firm that within the net. In that case, the importance of political ties might be devaluated to some extent. So, we argue that inter-organizational networks bring firms other options to access knowledge. Then, the influence of political ties might be weakened. The above arguments yield the following hypothesis.

Hypothesis 2: Inter-organizational networks negatively moderate the relationship between successor's political ties and former CEO's dismissal in such a way that the relationship would be weakened at a higher level of inter-organizational networks.

As one of the most influential emerging markets, China has its own characteristics. It has significant geographical institutions across provinces. The difference of geographical institutions makes political ties valued differently in firms. Research on organizations already emphasizes the convergence effect between organizational forms and strategies. They argue that organizational forms and strategies tend to converge around common structure and practices in an institutional environment under the pressure of existing norms (DiMaggio and Powell, 1983; Meyer and Rower, 1977). Institutional environments can change over a sufficient period of time. In the case of China, firms those located in different provinces are influenced by quiet different institutions which might be changing constantly. The widespread changes in national institutional environments, such as "institutional upheaval" or "institutional transition" (Hoskisson et al., 2000; Newman, 2000; Peng, 2003) can be a fundamental stimulus to strategic change for all the firms operating there.

As we mentioned that in different geographical institutional environments, firms might have other better choices to acquire resources and rather maintain their competitive positions. A firm that is managed in a location which is well developed in institutions, might access more opportunities and lower its cost in the routine businesses. And the need for seeking security by establishing political ties becomes also not so important that other area. Then the value and necessity of searching and maintaining political ties might be decreasing. And the important role of political ties also becomes weakened. So, we have the following hypothesis.

Hypothesis 3: Geographical institutions negatively moderate the relationship between successor's political ties and former CEO's dismissal in such a way that the relationship would be weakened at a higher level of institutional development.

2.3 Dynamic Resource Based View

While the theorists have paid explicit attention to investigate how sustained competitive advantage is achieved, more recent work on the temporary competitive advantage and the evolution of organizational capabilities suggests an application of dynamic resource-based theory (Helfat, 2000). The competitive advantage

could be eroded not only by the imitation and efforts of rivals, but also by environmental dynamics.

Changes in economic and industrial conditions are crucial environmental uncertainty for a firm. In the 1990 and 2000s, the technological advances in information, multimedia, and internet shaped the consumer behaviors and the competitive landscape in some industries. And in 2008, financial crisis challenged firms' capability financing and marketing. Dynamic nature of the business environment makes it very difficult to maintain a permanent competitive advantage, so the strategic success comes from a continuous stream of temporary advantages (Brown and Eisenhardt, 1998). In the shifting environment, firms need dynamic capabilities to integrate, build, and reconfigure internal and external competences (Teece et al., 1997). Helfat and Peteraf (2003) introduced a new concept of capability lifecycle (CLC) which provides a more fully dynamic approach to resource-based view. In that study, the authors describe founding, development, and maturity stages of capability lifecycle as well as retirement, retrenchment, renewal, replication, redeployment, and recombination branches after maturity.

Along with this logic, two scenarios of the firms' capability to manage social capital should be taken into account. Organizations seek to balance between exploitation of current resources and exploration of new resources. First, firms could exploit and utilize the top managers' social capital over time, and then achieve and maintain capabilities to invest and develop such social capital. Firms in later stages are able formalize their own network which provides a different type of strategic resource in the exchange at organizational level. As the inter-organizational ties become more important, consequently, the top managers' personal ties begin to lose crucial importance (Bratkovic et al., 2009). Therefore, the firms' capability of developing social ties goes into maturity. Second, it is also pointed out that "it is unlikely that a firm's competitive position is solely attributable to any one specific resource or capability (Newbert, 2008)". A firm has to deal with different challenges in the life stages, so needs to renew or update the capability of developing social capital of a new kind. Assume that the social capital the current top managers' provide could not satisfy the firm's growth, then the top managers' network will also become less valuable.

Specifically, after the firm has gained the capability of managing the political capital by exploiting the current top managers' political connections with the government, the top managers become less attractive to the firms. Winter (2000), the famous scholar, notes that a crisis may motivate the organization to improve the level of capability. To survive in the dynamic environment, firms also tend to explore new set of political ties which are useful for the future. For instance, when financial crisis came out in 2008, some businesses may rely more on financial support from the government, so have to update their capability of establishing the network with government officers who have power in the banking sector. As such, it is not surprising that CEO with political ties is more likely to be dismissed and succeeded by other new alternatives in the renewal of organizational capability.

The political ties create power for incumbent CEOs, which make them maintaining their position at least in a short period of time. However, the power is a circulation created by the interplay of two underlying mechanisms: obsolescence and contestation (Ocasio, 1994). The firm is seen as a political coalition and executives as its primary political brokers in political theories of organization (March, 1962; Cyert and March, 1963). In this kind of organization, CEOs play a central role in the dominant coalition by exercising their influence through both their formal authority and their informal power (Pfefer, 1992). In the global financial crisis in 2008, firms are managing themselves to minimize the negative influence of uncertainty. Under both the internal political processes and external uncertainty, incumbent CEOs' previous political ties lose their value. Then those firms' behavior might respond to the new interests and belief of the future dominant coalition to benefit them. My argument yields the following hypotheses:

Hypothesis 4: After taking positions for a certain period of time, politically connected CEO is more likely to be dismissed.

My overall theoretical framework is illustrated in Figure 1.

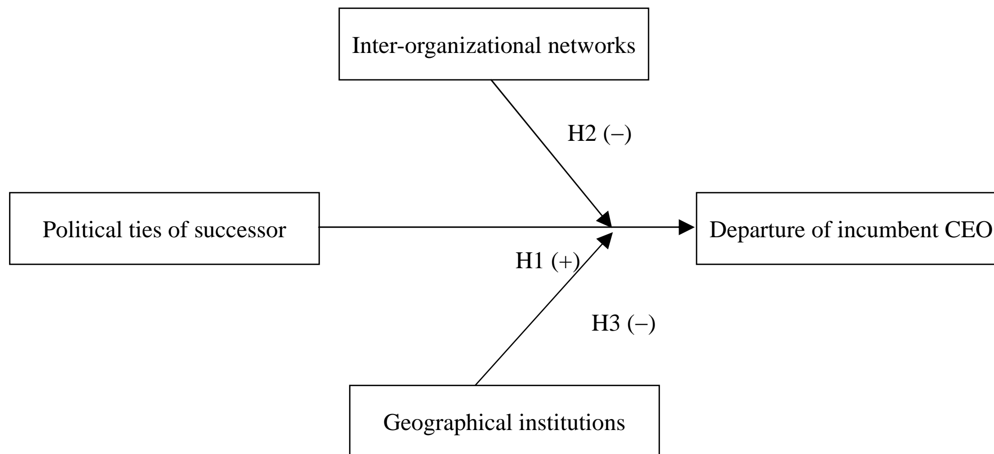

Figure 1 Theoretical Model of Hypothesis 1, 2 and 3

2.4 Contextual Social Capital

Social capital influenced by the norms, values, and sanction mechanisms of the society refers to a feature of a country's social structure (Coleman, 1988), so it is necessary to study social capital in the different national contexts. Comparative studies between societies, such as France, Italy, and China (Fukuyama, 1995), have shed insights on the dynamics of social capital. Lin and Si (2010) proposed a conceptual framework to account for the dynamics of social capital by using Chinese cases, and called for comparative empirical research on this issue.

In this paper, I specialize in the institutions of China, which have different levels of market development. The two countries differ in institutions in terms of formal laws and regulations and informal norms and values (North, 1990).

China has been encountering problems like market fragmentation, state intervention, and rent-seeking activities (Huang, 2008). Chinese government exercises control over firms' operations and management in terms of resource distribution, investment size, bank loans, public policies and industrial support (Li et al., 2006). Chinese organizations find that investing in and maintain "guanxi" with the government is necessary for their survival (Peng and Luo, 2000). Nowadays, the Chinese firms have more and more incentives as well as opportunities to participate in political processes to obtain valuable information and favorable government policies.

Generally, the Chinese firms get their political connections in the following ways. First, in the wave of "Xiahai"[1] in 1990s in China, some prior government officials who could get rare resources via their social network have established their own companies and become entrepreneurs. So these kinds of firms are born with political connections. Second, the managers in state-owned enterprises and collectively-owned enterprises in China usually have similar positions with government officials in the hierarchy, and such firms have political background by nature. It should also be noticed that, in the process of privatization, some state-owned enterprises and collectively-owned enterprises became private through restructuring or MBO. The prior managers who then

[1] "Xiahai" is a special Chinese term which means the officials resign from the government or institutions, and set up their own business.

become new owners or top managers could provide political capital to the new private firms. Third, the top managers in Chinese firms could be legally elected as members of the Chinese People's Political Consultative Conference (CPPCC), National People's Congress (NPC) and Communist Party of China National Congress (CPCNC). As members of CPPCC, NPC and CPCNC, they could influence the policy-making process directly by giving suggestions and indirectly by joining in the network of government officials. In this way, the firms could cultivate their political connections.

The various levels of Chinese government exercise different functions and powers. The central government makes plans for macro-economy, such as industrial preferential policies, and monetary policies. The ministries of central government also take charge of the supervision for public firms, support for the special programs and so on. The local government could provide the firms with land, execute approval authority for administration, affect financing and loading from banks, and intervene in other daily affairs. So when firms have connections with the higher levels of government, they may obtain important information and supporting policies for investing into profitable project, entering new markets, getting listed, etc. If they have connections with lower levels of government, firms may operate in a more favorable environment as well as get financial support easily.

3. Method

3.1 Sample

The sample of Chinese firms was selected from firms listed in the Small and Medium Enterprises Segment in the Chinese stock market. I obtained the data for my empirical analysis for Chinese firms from the following sources. First, I collect the basic information of Chinese firms from Sinofin, a database compiled and maintained by the China Center for Economic Research at Peking University. Second, I cross checked the basic data with Wind Chinese Financial Database provide by a Chinese company called Wind Info. Third, I got detailed information on the resumes of top managers from the published annual reports of the listed firms. Forth, I collect the information about CEO dismissals from the famous GTA Information Technology Company who provides comprehensively relative data about all the listed firms in China. Governance Structure Dataset is suitable for collecting data of CEOs' turnovers.

3.2 Measurement

3.2.1 Political connection

I use three dummies to measure the firms' political capital. The Chinese government has multiple tiers of provinces, municipalities, cities, counties, municipal districts, towns, and nationality towns. Accordingly, I focus on CEO and chairmen's connections with the government on three main levels in this paper. First, I encoded province-level 1 if the CEO and chairmen are either a prior official of and above the province and ministry level government or a member of CPPCC, NPC or CPCNC of and above the province level; otherwise 0. Second, I encoded city-level 1 for the CEO and chairmen who have prior position or membership of and above the city level. Third, I encode county—level 1 for the CEO and chairmen who have prior position or membership of and above the county level. It should be pointed out that I use the connection of both CEO and chairmen in that the chairmen of board has dominant power in Chinese firms and usually holds a concurrent position of CEO. Given the president makes the final decision for the strategic actions of the firm, it is necessary to investigate the roles of both CEO and chairmen.

3.2.2 CEO forced departure

There are various reasons for CEO turnover. It might happen either because of the incumbent CEO's voluntary leave or as a result of its forced departure. Separating the voluntary leave and forced departure are the main issue in the succession literature. Fortunately, for Chinese sample, the data source reports the details of information about reasons why a CEO leaving his or her position. That makes my identification of dismissals convenient and confirmative. I define that a CEO dismissal happens when his or her career terminated abnormally. Or by other words, I identify CEO dismissals depending on the reasons that reported when the CEO leaves the position. Because the GTA reports the reasons that cause CEOs leaving their position in detail, I can easily identify the dismissal observations. In sum, in line with previous research, I only focus on the forced departures that appear in the data source.

CEO turnover is a dichotomous dependent variable, and it is coded as 1 if the event of CEO turnover occurs and 0 otherwise. In China, "general manager" is the statutory title used in China's Company Law and is equivalent to CEO in the West (Pi and Lowe, 2010).

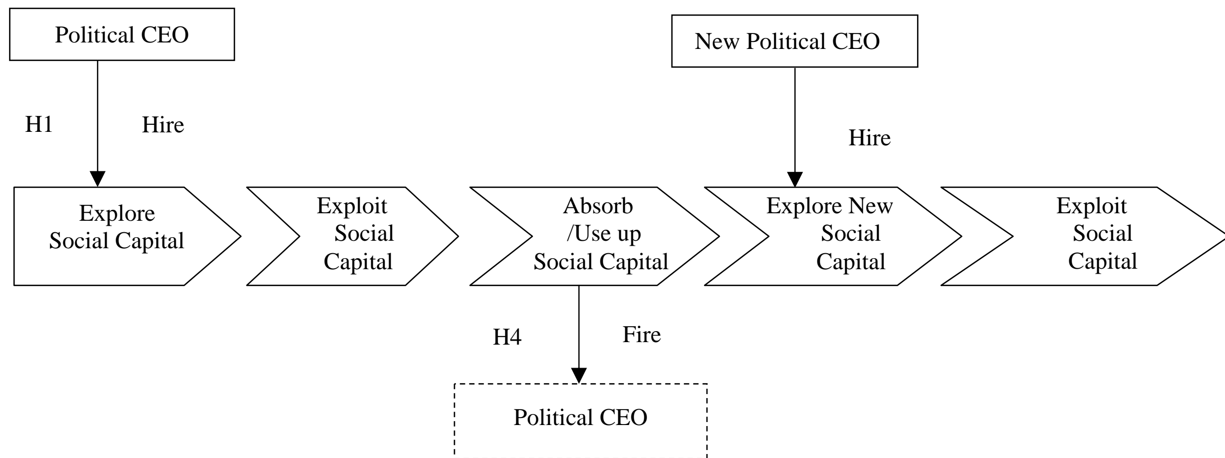

Figure 2 Framework of Turnovers of CEOs with Political Ties

3.2.3 Institutions

We used the measurement of marketing index introduced by the National Economic Research Institute, China Reform Foundation who reports the index every year. The measurement represents the general adoption of the market principle of every province in China, which is widely adopted by scholars (James and Lauson, 2006).

We select the three many index: market score, government score and law score. And the principal component analysis is used to extract a variable name "institutions" in models. Market score measures the development of production and factor market across provinces. The government score represents the relationship between local government and market. Law score measures the development of industry associations and commercial intermediaries, as well as the legal institutional environment. Each of the three measurements ranges for 0 to 10. The higher score means the higher maturity of institutional development. More details of the information please see the Appendix.

The calculation of those indexes is from two ways, based on the theoretical relationship between indexes score and the degree of market development. When the index value is positively related to the degree of marketization, the score will be calculated using the following equation (1), which means that the higher index value, the higher index score. For instance, the index "labor mobility" is measured by

$$Score = \frac{Vi - V\min}{V\max - V\min} \times 10 \qquad (1)$$

Above *Vi* is the original data of *ith* index of a province; *Vmax* is the largest original value of corresponding index among the 31 provinces; while *Vmin* the smallest value.

When the index value is negatively related to the degree of marketization, it is calculated based on the following equation (2). Then higher original value, lower the index score will be. For instance, the score of the index “cutting down the regional protectionism in commodity market” is measured by the situation of regional trade barrier in the sample, which is calculated using the following equation (2). The score of the *ith* index is calculated by the following equation:

$$Score = \frac{V\max - Vi}{V\max - V\min} \times 10 \qquad (2)$$

3.2.4 Network centrality

We measure the centrality of each firm using the following equation (1). It worth mentioning that here my analysis is conducted at the firm level by taking every firm as an actor. The measurements of centrality do capture the actions of individual firms, which is our main concern. The degree centrality is calculated by the following standardization of the measure:

$$C'_D(n_j) = \frac{d(n_j)}{g-1} \qquad (3)$$

That equation summarizes the proportion of nodes that are adjacent to n_i . And $c'_D(n_i)$ is independent of g, and thus can be compared across networks of different sizes.

3.2.5 Controls

I also incorporated a series of control variables to isolate the CEO- and firm-level influences on depend variables. Firm size is typically associated with the degree of formalization, bureaucracy, and requirements for managerial expertise of a firm (Hamori, 2006), which affects not only the efforts needed for replacing a CEO, but also the availability of the candidates for CEO (Pi and Lowe, 2010). The firm size is measured as logarithm of total assets. To control the impact of CEO retirement policy on CEO turnover, a dummy variable of CEO age is used in this study. It is coded as 1 for CEOs who are 60 years old and above and 0 otherwise (Pi and Lowe, 2010). Previous literature (e.g., Datta and Guthrie, 1994) argued that CEO’s educational background affect the CEO turnover. CEO’s education level was estimated using following criteria: below junior college; junior college; college; master degree; Doctoral degree. Thus I measured turnover type for CEO and his successors for Chinese firms.

3.3 Analytical Methods

My main dependent variable is CEO dismissal, and thus I used Cox model which offers the best approach to modeling time dependence. The Cox proportional hazard model is a semi-parametric regression model (Hosmer et al., 1999) in which the baseline hazard is given no particular parameterization. I also employed Gompertz regression for robustness check. Unlike the semi-parametric Cox regression, the Gompertz model assumes that the baseline hazard takes on a specific parametric functional form. Note that results from one method each are shown in the table due to space limitations.

4. Result

Table 1 provides summary statistics.

Table 1 Description and Summary Statistics of Key Variables

Variable	Mean	Min	Max	Label
Political Connection				
Province-level Connection	0.06	0	1	1 if CEO connected with Province-level government
City-level Connection	0.10	0	1	1 if CEO connected with City-level government
County-level Connection	0.21	0	1	1 if CEO connected with County-level government
Control Variables				
Assets†	20.69	19.20	22.73	Asset (log)
CEO Age Dummy	0.19	0	1	1 if age of CEO is over 60
Education	3.26	1	5	1 if below junior college; 2 junior college; 3 college; 4 master degree; 5 Ph.D
Origin	0.74	0	1	1 if CEO comes from inside firm
Follower type	0.63	0	1	1 if CEO followed by insider succession

Note: † Natural logarithm.

Table 2 shows correlations matrixes for key variables used in the study. And we present the inter-organizational networks in the Figures 3 and 4.

Table 2 Correlation Matrix

	1	2	3	4	5	6	7	8	9	10	11
Asset	1.00										
CEO age	-0.01	1.00									
	(-0.92)										
CEO Education	0.02	-0.26	1.00								
	(-0.73)	(0.00)									
Origin	-0.05	-0.14	-0.09	1.00							
	(-0.52)	(-0.48)	(-0.29)								
Follower type	-0.03	-0.05	-0.06	-0.15	1.00						
	(-0.73)	(-0.51)	(-0.45)	(-0.44)							
Province -level	0.00	0.03	0.04	0.01	-0.05	1.00					
	(-0.97)	(-0.72)	(-0.53)	(-0.95)	(-0.47)						
City-level	-0.01	0.06	-0.04	0.04	0.01	0.75	1.00				
	(-0.83)	(-0.41)	(-0.50)	(-0.58)	(-0.87)	(0.00)					
County-level	0.06	0.05	-0.03	-0.13	-0.09	0.50	0.67	1.00			
	(-0.25)	(-0.50)	(-0.60)	(-0.10)	(-0.22)	(0.00)	(0.00)				
Country-level (Successor’s)	0.02	-0.05	-0.06	0.13	0.02	-0.06	-0.08	-0.12	1.00		
	(-0.81)	(-0.54)	(-0.52)	(-0.54)	(-0.82)	(-0.44)	(-0.32)	(-0.15)			
Province-level (Successor’s)	-0.02	-0.01	-0.20	0.18	0.01	0.00	-0.04	-0.05	0.71	1.00	
	(-0.78)	(-0.91)	(-0.02)	(-0.38)	(-0.91)	(-0.99)	(-0.61)	(-0.52)	(0.00)		
County-level (Successor’s)	-0.01	-0.07	-0.16	-0.07	-0.11	0.02	0.02	0.13	0.52	0.73	1.00
	(-0.95)	(-0.43)	(-0.07)	(-0.75)	(-0.16)	(-0.80)	(-0.86)	(-0.12)	(0.00)	(0.00)	

Note: p-values in parenthese.

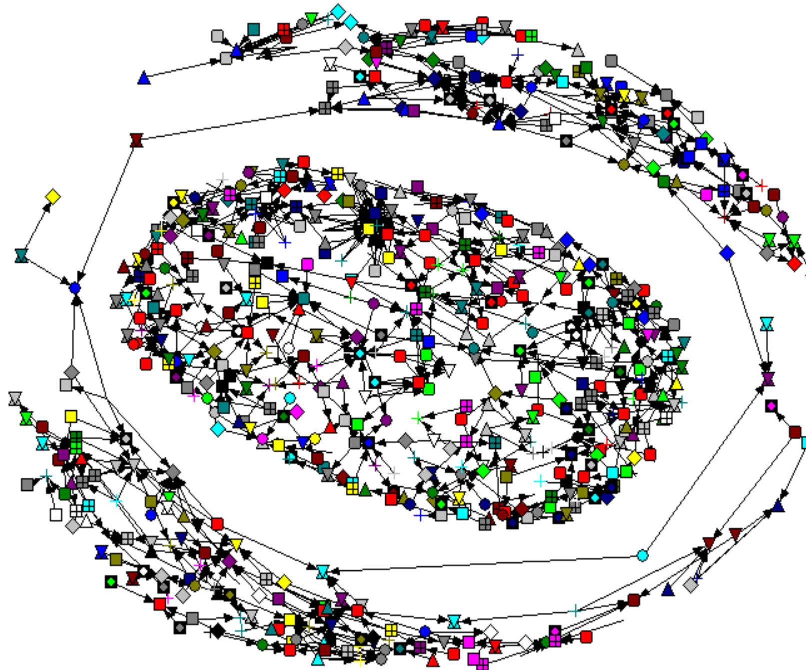

Figure 3 Inter-organizational Networks in 2008, Individuals as Actors

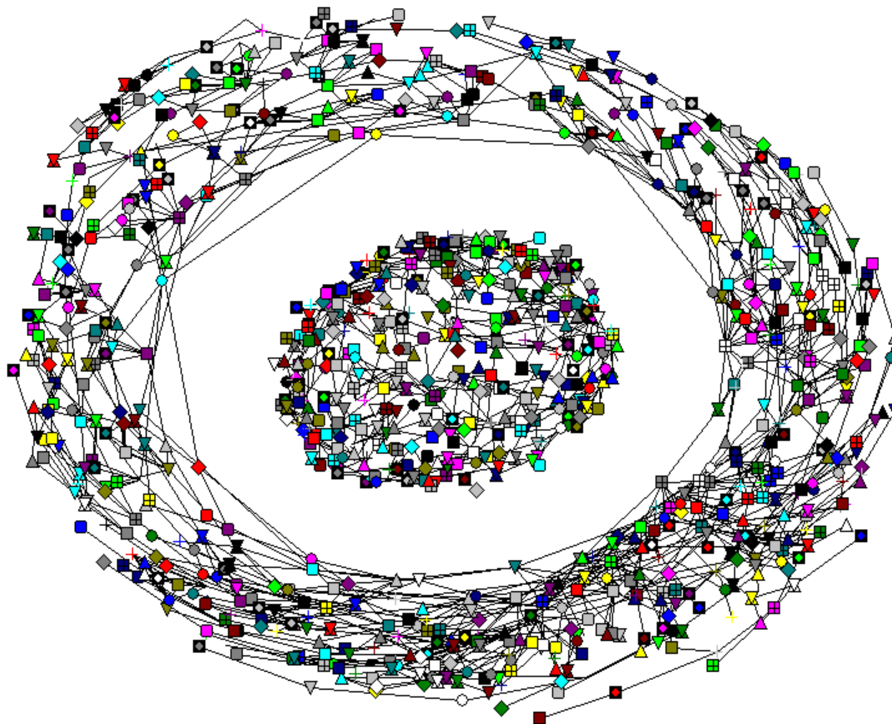

Figure 4 Inter-organizational Networks in 2008, Organizations as Actors

For Hypothesis 1, I posited that former CEOs are more likely to be dismissed if their successors have political connections. So, my hypothesis 1 is supported.

I argued that, in Hypothesis 2, if CEOs have political connections, they are more likely to be dismissed after they taking positions for a long time. The findings provide strong support for this hypothesis, confirming that

political connections of CEO are significantly related with CEO dismissal. As shown by Model 4 and 5 in Table 3, the coefficients of province- and city- connections are all positive and significant, which indicates the higher dismissal rate of relevant CEOs who having the correspondent political ties (coefficient = 83.18, p-value < .01; coefficient = 12.99, p-value < .10).

Table 3 Result of Hypothesis 1 and 2

	Hypothesis 1 (Gompertz Model)			Hypothesis 2 Institutions (Gompertz Model)			
	Model 1	Model 2	Model 3		Model 4	Model 5	Model 6
Political connection							
Institutions				1.42**	0.44**	0.49	0.93
				(-0.03)	(-0.03)	(-0.39)	(-0.88)
Province-level	31.98**				0.76		
	(-0.03)				(-0.56)		
Institutions×Province-level					-2.37***		
					(-0.00)		
City-level		0.39				0.25*	
		(-0.50)				(-0.06)	
Institutions×City-level						-2.08*	
						(-0.06)	
County-level			0.68				0.24**
			(-0.71)				(-0.03)
Institutions×County-level							4.98
Control							(-0.26)
Assets	0.24**	0.44	0.42	-0.87	0.35	0.61*	0.40*
	(-0.03)	(-0.13)	(-0.12)	(-0.52)	(-0.11)	(-0.08)	(-0.07)
CEO age	1.77	1.86	1.65	0.26	2.58	2.156	2.24
	(-0.64)	(-0.59)	(-0.66)	(-0.23)	(-0.48)	(-0.43)	-0.52
CEO education	0.92	1.04	0.93	-2.64	0.75	0.68	(0.72)
	(-0.85)	(-0.95)	(-0.88)	(-0.128)	(-0.56)	(-0.52)	-0.66
Origin type	0.52	0.77	0.73	-2.17	0.68	0.46	0.28
	(-0.44)	(-0.74)	(-0.71)	(-0.24)	(-0.19)	(-0.13)	(-0.39)
Follower type	0.25*	0.35	0.36	-2.06	0.12**	0.14**	0.32
	(-0.06)	(-0.12)	(-0.13)	(-0.22)	(-0.03)	(-0.04)	(-0.15)
Log likelihood	-16.46	-18.15	-18.32	-8.202	-10.28	-13.9	-14.34
Number of observations	126	126	126	126	126	126	126

Hypothesis 3 was also partly supported. In China, connected (only county-level) CEO is resigned, his or her successor are selected from the CEO who has country-level connection. Note that other levels of connections in China are not provided in the regression because of multi-collinearity. In sum, all the Hypotheses are partly supported. Implications will be discussed in next section.

Table 4 Result of Hypothesis 3

	Hypothesis 1 (Gompertz Model)				Hypothesis 3 Networks (Gompertz Model)		
	Model 1	Model 2	Model 3		Model 4	Model 5	Model 6
Political connection							
Network Centrality				5.01**	2.86	2.19	0.59
				(-0.04)	(-0.49)	(-0.73)	(-0.40)
Province –level	31.98**				0.87		
	(-0.03)				(-0.58)		
Centrality×Province -level					-3.68***		
					(-0.00)		
City-level		0.39				3.49	
		(-0.50)				(-0.49)	
Centrality×City-level						-2.51*	
						(-0.16)	
County-level			0.68				0.92
			(-0.71)				(-0.85)
Centrality×County-level							-2.57
Control							(-0.38)
Assets	0.24**	0.44	0.42	-0.67	0.61	0.39*	0.20*
	(-0.03)	(-0.13)	(-0.12)	(-0.42)	(-0.01)	(-0.37)	(-0.07)
CEO age	1.77	1.86	1.65	0.56	2.45	2.79	1.36
	(-0.64)	(-0.59)	(-0.66)	(-0.13)	(-0.58)	(-0.93)	-0.62
CEO education	0.92	1.04	0.93	-2.74	0.95	0.79	(0.72)
	(-0.85)	(-0.95)	(-0.88)	(-0.17)	(-0.59)	(-0.62)	-0.76
Origin type	0.52	0.77	0.73	-3.17	0.40	0.73	0.50
	(-0.44)	(-0.74)	(-0.71)	(-0.25)	(-0.09)	(-0.53)	(-0.29)
Follower type	0.25*	0.35	0.36	-1.06	0.16**	0.15**	0.20
	(-0.06)	(-0.12)	(-0.13)	(-0.22)	(-0.13)	(-0.13)	(-0.05)
log likelihood	-16.46	-18.15	-18.32	-8.902	-12.98	-13.9	-16.24
Number of Observations	126	126	126	112	112	112	112

Table 5 Result of Hypothesis 4

	Hypothesis 1 (Gompertz Model)			Hypothesis 4 (Gompertz Model)		
[China]	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Political connection						
Province -level	31.98**			83.18***		
	(-0.03)			(-0.00)		
City-level		0.39			12.99*	
		(-0.50)			(-0.07)	
County-level			0.68			2.98
			(-0.71)			(-0.18)
Control						
Assets	0.24**	0.44	0.42	0.31	0.281*	0.30*
	(-0.03)	(-0.13)	(-0.12)	(-0.11)	(-0.09)	(-0.07)
CEO age	1.77	1.86	1.65	2.35	2.169	2.24
	(-0.64)	(-0.59)	(-0.66)	(-0.48)	(-0.53)	-0.52
CEO education	0.92	1.04	0.93	0.75	0.78	(0.82)
	(-0.85)	(-0.95)	(-0.88)	(-0.56)	(-0.62)	-0.66
Origin type	0.52	0.77	0.73	0.30	0.33	0.48
	(-0.44)	(-0.74)	(-0.71)	(-0.19)	(-0.23)	(-0.39)
Follower type	0.25*	0.35	0.36	0.12**	0.14**	0.30
	(-0.06)	(-0.12)	(-0.13)	(-0.03)	(-0.04)	(-0.15)
Constant	4.434e+12**	8716991.61	31356191	5.195e+10*	2.830e+11*	2.832e+10*
	(-0.03)	(-0.15)	(-0.13)	(-0.09)	(-0.07)	(-0.07)
log likelihood	-16.46	-18.15	-18.32	-12.28	-13.9	-14.34
N	126	126	126	129	129	129

Note: p-values in parentheses * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

5. Discussion

This paper provides an empirical examination of the factors influencing CEO turnover in Chinese listed companies. This paper further investigated succession type of politically connected CEOs. First important finding of this study is that CEO turnover is affected by political connection of top manager. I found that politically connected CEOs are more likely to be dismissed than CEOs without connections. My results look counterintuitive and contrary to previous studies. Pi and Lowe (2010) found that political connections, measured by membership to the People's Congress (PC) or Chinese People's Political Consultative Conference (CPPCC), provide Chinese CEOs with significant power to protect them from being replaced involuntarily. The resource dependency theory (Pfeffer and Salancik, 1978) argues that executive power can be derived from abilities to provide firms with vital resources. Thus CEOs with political connections are important assets for firm because it can make business operations easier and thus CEOs may acquire power from their political connections. However, in this study, I proposed new perspective using dynamic resource based views. Firms have to deal with different challenges in the life stages and so update the capability by changing politically connected CEOs. Thus, politically connected CEOs can be easily dismissed after firm extracted their political resource. My findings can be also interpreted with dynamic model of "exploration" and "exploitation" (March, 1991). After the firms exploit the CEOs' political resources, they explore another political capabilities by appointing new CEOs. As Gupta et al. (2006) pointed out, very few studies have examined the dynamics of each of these mechanisms in different contexts. My study might be first attempt to investigate how firms achieve the optimal adaptation by ceaseless choice between exploration and exploration.

Second, I found that CEO turnover is associated with its successor's political connections. The power perspective highlights interest conflicts and power struggles within organizations, especially among senior executives (Lazear and Rosen, 1981). For example, Fama (1980) proposed that competition among top managers plays an important role in the internal monitoring of firms. However, no previous studies within my best knowledge, examine the power contests between politically connected CEOs. I argued that incumbent CEOs are vulnerable to the power contest with new CEO candidates who have powerful political resources if they have not proven their political capability. My result suggests that new emergence of politically connected candidates can increase the dismissal rate of incumbent CEOs. Thirds, I found that politically connected CEOs are replaced by new politically connected CEOs. Especially my results shows that type of successors' political connection are similar with that of incumbent CEOs. For example, after elite is dismissed, other elite will take this position. Why do firms need similar kind of political resources? When politically connected CEOs are appointed as a firms' CEO position, they try to utilize their political resources and construct social network with government during their tenure. When the firms run out of their incumbent CEOs' political resources, firms would like to utilize the existing social network. Thus firms recruit the CEO who has similar type of political resources. This finding is aligned with perspective of exploration and exploitation (March, 1991) that the strategy of exploration depends on existing capability of firms.

Third, the findings of geographical institutions and inter-organizational networks are more interesting. We suggest that organizations those located in regions underdevelopment in institutions are more like to rely on political ties to access other resources and gain legitimacy. More importantly, inter-organizational networks are also valuable trajectories that could be utilized by firms to maintain their competitiveness. Firm can use inter-organization networks to learn and share knowledge. Thus, the importance of political ties decreases. Our

hypotheses about those arguments are strongly supported by the empirical results.

Lastly, I found that effect of successors' connections is related with dismissal rate of incumbent CEO only in China. This result suggested that political connections of Chinese CEO is are more vulnerable to power contest with successors. This finding is very interesting and may be interpreted as the difference in market institutions. Chinese business environment is more volatile and dynamic. To deal with unpredictable environment, Chinese firm may easily discard the incumbent CEO and scout new manager if the candidate has updated political resources.

Despite the contributions, it is worth noting some limitations of this study. First, the sample of this study includes only companies listed on the Chinese stock markets. Thus it is not safe to claim that these results would necessarily hold for non-listed companies in China. However, further study could be done on Chinese non-listed firms to generalize my study to other settings. Second, I did not take consider of performance effect on CEO turnover. The prior research of CEO turnover found that firm performance (Pi and Lowe, 2010) is negatively related with CEO dismissal. Fourth, I did not include effect of regime change. Siegel (2007) argued that change in political regime could change benefit of political connection into liability to firm. Unexpected regime change can negatively affect the CEO's tenure if he had political connection with ruling party. In China, I cannot observe the regime change. However when political patrons lose their position because of corruption, the CEOs who had connection with these officials lose all the benefit from connection, and they are more likely to be dismissed. In the future, researchers may construct relevant variables based on this information to comprehensively explore change of political situation and its impact on CEO turnover.

The present research provides insight into determinants of politically connected CEO turnover using Chinese firms. Based on dynamic resource theory, my analysis confirmed that politically connected CEOs are vulnerable to power contest. In addition, I showed that political connection can increase the dismissal rate of incumbent CEOs. I also found that firms prefer the similar type of political connection when they run out the capability of incumbent political resources.

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The Moderating Effect of Organizational Culture between Proactive Market Orientation and Hotel Business Performance in Thailand

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Abstract: The purpose of this study is to examine the relationship between Proactive Market Orientation and Business Performance of large size hotels in Thailand. With some impact caused as a moderating effect by Organizational Culture. Hypothesis respecting the relationship between Proactive Market Orientation and Business Performance with impact by Organizational Culture will set and test. Data collection uses a mail questionnaire survey approach. This study employ a simple random sampling procedure in selection the large size hotels for inclusion in the sample. A total of 310 director of marketing in large size hotels in Thailand will be participates in this study. Factor Analysis, Correlation analysis, Linear and Hierarchical Regression methods of data analysis will use for hypotheses testing. The research result will provide the in depth knowledge on the nature of proactive market orientation practices in large size hotels in Thailand as well as the moderating effect of the organizational culture towards business performance. This study, hence, will be widely beneficial for hotel executives, business operators, the Thai government, and the academic.

Key words: proactive market orientation; business performance; large size hotels; Thailand
JEL code: M31

1. Introduction

In Thailand tourism is considered an important service sector for the country's economic system; hotel and lodging businesses are directly related to the system. This is aside from their being the chief sources of employment and incomes of the country (Ministry of Tourism and Sports of Thailand, 2011). The Thai government placed importance on these sectors by allocating budget to establish good images of the tourism in order that Thailand would continue to be a tourist destination, especially for foreigners (The Thailand Board of Investment, 2009) However, the competition tendency in the tourism and hotel industry have become more aggressively during these years. What's more, the change has been made very quickly and effectively, resulting from the unavoidable, negative factors, either internal or external ones (the Eleventh National Economic and Social Development Plan of 2012-2016).

The internal factors are labors (the Office of Small and Medium Enterprises Promotion, 2010). But the

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problems caused by the external factors are many; they are, for example, the political restlessness, economy, natural disasters, social and crime problems (the Eleventh National Economic and Social Development Plan of 2012-2016). In particular, political and natural disasters in the previous years had caused a reduction in the numbers of tourists from East Asia, Europe, South Asia, Middle East, the Americas, Oceania and Africa (Office of Tourism Development, 2009).

From the aforementioned circumstances in which the factors, both internal and external ones, had effects upon the organizations, it is needed that, to survive, both the hotels and residences in Thailand had to do some adjustments in their businesses. Each organization must apprehend the importance of its internal resources; initiate its own corporate identity, the type which no other organizations can ever imitate—being inimitable, valuable, and exceptional. The organization then can be comfortably survived because of the sustainable advantages it has in any completion to occur in marketplaces (Barney, 1991).

1.1 Problem Statement

Tourism as the service industry has had an important role in Thailand's economic system. This is because, apart from its being able to create the country's highest incomes among all service merchandise, it also generates many other continuity businesses. Among them are restaurants, souvenir shops, transportations, and, especially, hotels and lodging businesses—the direct continual industry (Thammasat University, 2009). However, in the past 7 years, Thailand experienced many a crisis, which became its limitation to maintain the current markets and expand their market opportunities into new territories. In each crisis, particularly the political and natural problems, there had been clear effect to the change of the numbers of the tourists and the hotel guests (National Tourism Development Plan of 2012-2016, 2011)

Moreover, the economic problem, as additional outside impact, had an effect upon Thailand's hotel businesses and its tourism. The instability of currency values as occurred in many important countries in Europe, United States of America, and Australia, caused direct impact on Thailand's tourism and hotel businesses in the past 1-2 years. The softness of these monetary classes: 15-25% Euro, 10-15% US dollar, and 10-15% pound sterling, all cast effect upon Thailand's hotel and tourism businesses, causing the decrease to its performance returns, especially in 2009-2010. Averagely, all hotel performance returns throughout the year were decreased by 15–20% and the occupancy rate was reduced by 15%. During the 2010 second quarter, Thailand's cross domestic product for hotel and restaurant businesses was 38,099 million Baht, 15.4% decreased from the first quarter, which was 45,052 million Baht (Office of the National Economic and Social Development Board, Office of the Prime Minister).

The key factor was the strong Baht currency which made pound and Euro currencies higher in value following the exchange rate (Thai Ministry of Finance, 2011). The effect was especially felt in the Thai 5-star hotels, resulting from the reduced numbers of the tourists (Prachachart Turakij Newspaper, 2011) and a reduced number of hotel occupancy rates of the European tourists (Office of Tourism Development, 2011).

As regards the internal factors having effects on Thailand's hotels and accommodations businesses, it was found that, according to the 2009 study conducted by the Office of Small and Medium Enterprises Promotion, the problems occurred as a result of the internal factors were labor; this is as encountered by the hotels and lodging organizations in many years past. The personnel in the organizations lacked language skills and had no workplace loyalty. They cared much only of their own benefits. These factors have effect upon the high turnover rate (Office of Small and Medium Enterprises Promotion, 2010). In the meanwhile, the personnel who possess high

knowledge and skills tended to be attracted by the hotel competitors, where higher salary/benefits were offered. Of course, this stemmed another problem—time and money to spend on looking for and training the new employees to replaced the older ones (Managers Magazine, 2011). Under such situations in which hotels and residences in Thailand had to face both the internal and external problems, as mentioned earlier, the organizations need to get adapted to be survived as well as to get advantageous over the business competitors. However, one more resource. This is Market Orientation, as Appiha-Adu and Ranchhod (1998) state in Marketing Science that market orientation is something like "the heart of the theory and practice of marketing management and is believed to be the foundation for a firm's competitive strategy."

According to marketing academicians and executives, Kotler (1977), Levitt (1960) and Webster (1988), organizations can potentially upgrade their performance by utilizing the market orientation concept to identify the needs and wants of customers. As a result, those market oriented organizations are more likely to operate their businesses more productively. This is because the organizations have clearer ideas and better guidance to identify and fulfill the customer needs (Jaworski & Kohli, 1993). Moreover, the external and internal elements as well as any involved activities can be more effectively monitored or concentrated when managers make use of the market orientation concept (Tomášková, 2005).

Furthermore, the philosophy of the marketing concept attributes successful business objectives to several ingredients including the integration of market activities and effective ways to identify and satisfy the needs and wants of target markets over their competitors (Kotler, 1997). In order to accomplish their ultimate objectives, organizations are therefore supposed to maintain their competitive advantage by offering special values to customers (Porter, 1985). Recently, competition situation in Thailand hotel business being one of seriously problem (Bank of Thailand, 2012) that facing in this sector, there are many strategies using for competitive advantage. So, paying more intention to the integration of market activities in the effective ways would be positive effect to the successful of Thailand hotel business performance as well.

However, the organizational culture is one group of internal barriers of market orientation since, organizational culture influences system, structure, procedure and communication in a firm so, organizational culture has a great influence on other internal element and direct fall in to the group of important elements connected with internal barriers of developing market orientation in the firms.

In order to attain this objective, therefore, more advance examination in market orientation is to be carried out. In this study, in particular, the proactive market orientation are to serve as independent variables for testing the framework of the study in addition to examining the moderating effect created by organizational culture.

1.2 Research Questions

(1) How does proactive market orientation (The firm's strategic emphasis, Entrepreneurial culture, Organizational slack, the firm's strategic Flexibility and Latent Needs Fulfillment) affect organizational performance in a Thai hotel performance context?

(2) How does organizational culture moderate effect between proactive market orientation and organizational performance?

1.3 Research Objectives

The objectives of this research are to investigate the relationships or the influence of two main variables that is, proactive market orientation, organizational culture, and business performance in large size hotels in Thailand. For this

reason, the objectives, which result from the research questions above, intend to search for the following answers:

(1) To determine the relationship between proactive market orientation and business performance.

(2) To investigate the relationship between proactive market orientation and business performance being moderated by organizational culture attributes.

2. Literature Review

2.1 Business Performance

The business performance measures in the previous study can be categorized into two main groups: financial performance and non-financial performance. The financial performance indicators refer to profitability, return on investment, sales growth and return on asset. Non-financial performance indicators include: customer satisfaction, new product success, customer retention, organization commitment, product quality, productivity, employment levels, market share.

However, the highly competitive business environment and the need to link the organization strategy with performance have led many organizations into adopting the multiple dimensions of business performance, including financial and non-financial performance indicators. With multiple dimensions of performance, a more comprehensive operationalization of organization can be offered (Venkatraman & Ramanujam, 1986).

Moreover, financial and non-financial performance measures in the literature also can be categorized into two main groups: subjective and objective measures. However, objective data can be difficult to interpret (Cooper, 1979). Assuming respondents' reports are accurate financial data, the information, nonetheless, may be interpreted in different ways. For example, the report of low profits or even losses in growth-oriented businesses may not necessarily indicate poor performance, as this could be because of significant spending on product and market development (Covin and Slevin, 1989). Objective performance measures, for example, profitability, may not be a true signal of a company's health (Dawes, 1999). A business unable to collect payment from customers, for example, may suffer from liquidity problems until written off as a bad debt would not reflected in objective profit measures.

Subjective measures are more likely to better deal with this type of occurrence. Subjective performance assessments permit an easier comparability across different industries and situations (Pelham and Wilson, 1996) while objective measures of performance are influenced by industry-specific factors (Miller and Toulouse, 1986). Hence, directly comparing absolute measures for companies in different industries would be inappropriate. Subjective measures have been shown to be positively correlated with objective measures of performance as they are able to represent a reliable alternative (Dess and Robinson 1984; Slater and Narver, 1994). Venkatraman and Ramanajam (1986) state that subjective measures are "reasonable proxies for often unobtainable secondary-source data." Most studies making investigation on the effect of market orientation on organizational performance cite Dess and Robinson (1984), who considers subjective performance measures to be viable substitutes for objective measures.

Even though, the both of performance; subjective and objective appropriate to use in marketing research in order to measures business performance but, in this study the type of performance measure that use for measuring hotel business performance is subjective measures, there are the managers perceived business performance on the indicators of sale growth, sale volume, market share, occupancy rate, return on investment, profit, service quality, customer satisfaction and turnover rate by using Likert scale questionnaire.

2.2 Organizational Culture and Market Orientation

Organization culture can be briefly defined as management style and operational practices. It is a system of shared norms and beliefs, both of which are likely to influence management structures of the organization. On the other hand Gudlaugsson (2009) noted that company culture can create by management and staff as they as a team create organizational beliefs, values and directions all these internal atmosphere within the company is a very important moderator of market orientation. So, cultural differences and opinion forming in each organization might have effect on the link between market orientation and performance measures (Schalk, 2008) because, the developing market orientation in the organization still found one group of internal barriers that is organizational culture (Tomaskova, 2009). And concerning the relationship between market orientation and organizational culture have not been addressed in marketing literature yet (O'Cass and Viet Ngo, 2005).

Organizational culture, as mentioned in this study, will be measured with four items of the dimension model (2001) namely: involvement, consistency, adaptability, and mission. Organizational culture has become a significant key to the improvement of business performance by acquiring considerable royalty and adjustability from employees (Willmott, 1993)

Involvement as the act of part taking in organizations' activities and events is an effective strategy created in an organization to proffer authority to its executive staff to stimulate and to drive its emplyees to progress towards its desired goal (Lawer, 1996; Likert, 1961). Organizations' personnel at all levels, whichever positions they hold, chief executives, department managers, or ordinary personnel, all are engrossed in the success and all posses the sense of ownership. Of course, this perception will affect the job under their responsibility as well as the organization's ambition (Katzenbach, 1993; Spreitzer, 1995).

Consistency is one of effective qualities to make a solidified organization culture; gradually, stability, cooperation, and integration all will be established within the organization (Davenport, 1993; Saffold, 1988). As stated by Block (1991), behavioral norms, if firmly embedded, as the key values in both the leaders and followers, any goals desired to reach by an organization can easily be achieved, even if different viewpoints of the staff subsist in some degree in the organization. Consistency is what based on the stability and internal integration deriving from the general attitude (Senge, 1990)

Adaptability is, as mentioned by Kanter (1986), quite paradoxical in that the least responsive organization tends to be a well-integrated one. It is quite evidenced that internal integration and external adaptation do not go together. However, an organization can make appropriate adaptations through its experience with the customers, the mistakes, and its abilities to perceive what should be changed for a better (Nadler, 1998; Senge, 1990; Stalk, 1988)

Mission can assist an organization to instigate effective missions, including the purpose and direction if the mission has already been created in the organization. In addition, if established, mission can help the organization clearly identify its goals and objectives to project into the future (Mintzberg, 1987, 1994; Ohmae, 1982; Hamel & Prahalad, 1994). If an organization's basic mission changes, other changes in the organization culture take place.

2.3 Organizational Culture and Business Performance

It is known that organizational culture has become a significant key to the improvement of business performance by acquiring considerable royalty and adjustability from employees (Willmott, 1993) In 1990, the connections between organization culture and performance effectiveness was validated by many researchers. Such studies as made by Gordon and Diomaso (1992) and Dension (1990) pointed toward the positive linkage of these

two elements—the connection in which each has its own condition. In particular, as mentioned by these researchers, the culture would actually link to superior performance efficiency only when the culture was able to acclimatize to any changes made as a result of environment changes. What is more; the culture must not just be normally good and be widely made use of, it must have unique qualities. Also, it must be so exceptional good that no other organizations are able to replicate the one being employed by an organization. Recently, however, Hopft et al. (1992), Lewis (1994), Lim, (1995), Ray (1986), Willmot (1993) specified that the relationship between the organization culture and the performance efficiency were quite insignificant. In reality, the deduction about resource-based view of competitive advantage pointed out that the kind of culture being able to form a theory and generate any advantages depends on value, rarity, limitability, and sustainability inhered in the culture (Barrney, 1986)

One of the latest quantitative researcher papers on the linkage between organization culture and performance efficiency was conducted by Denison (1984) for 34 American companies. Throughout the successive 5 years, the form of organization culture employed by these businesses as well as their efficiency strategy was followed up and brought into judgment. The researcher collected information about their return on investment and sales volume to assess their overall operation. Also gathering was information on perceptions of work organization and participation in decision making. Even though there existed connection between effectiveness in financial performance and organization culture, some of his effectiveness indicators revealed different strength of the relationship having between the relationship of the culture and performance efficiency while supervisory leadership was linked to the short-term financial performance, decision making; and work design had linkage to long term financial performance.

2.4 Proactive Market Orientation

According to Naver, Slater, and Maclachlan (2000, 2004), the market orientation consists of two viewpoints. They are reactive or responsive orientation emphasizing on expressed needs of customers and proactive orientation emphasizing on latent needs of customers.

In spite of the fact that Naver, Slater, and MacLachlan (2004) are still studying the traditional responsive or reactive market orientation, they all have accepted that proactive market orientation enables organizations to realize the latent needs of customers better (Hurley and Hult, 1998; Patel and Patel and Pavitt, 1995; Griliches 1987; Freeman and Soete, 1997; Cantwell and Hodson, 1991)

Proactive marketing might be understood as the driving capability of businesses (Teece, Pisano and Shuen, 1997). This is done by organizing, managing and planning the use of organizational resources such as marketing plan and investments. This is also involved the adaptation to be relevant with the external changes of organizations such a recessions. Srinvansan, Lilien and Rangaswamy (2002) have categorized proactive market orientation into four key aspects. This includes the marketing strategic emphasis of organizations, its entrepreneurial culture, organizational slack, and the strategic flexibility of organizations. Besides, all related literature of Narver and Slater(1990) is taken into account. It explains about the dimensions of proactive market orientation like that mentioned in Narver et al. (2004) explaining proactive market orientation as the challenges of organizations to discover and satisfy the latent needs of customers. This has become another important variable (Narver et al., 2004)

Latent needs are interpreted as the needs of customers especially when they are unconscious of them (Naver et al., 2004). This kind of need is the key to the fulfillment of customers. According to Oliver (1997), the three

conceptual interpretations for the role of satisfaction and motivation have been suggested. These three include classic need satisfaction model, classic motivation model, and hierarchical motivation model (1997).

When people do not have basic things that they need or want, the needs will become dominant and powerful. This illustrates the classic need satisfaction model. This kind of needs is fundamental and is used a motivation for ordinary individual to fulfill their needs. As for the product or service satisfaction, in general, customers tend to have higher expectation towards the products or services provided by the organizations. They expect to use best products or services, but, in reality, those products or services may not be like what the customers originally expected (Oliver, 1997). Similarly, Slater (2001) pinpoints that organizations are supposed profoundly understand both the expressed and unexpressed needs of customers. Besides, organization must develop market information and evaluation to be relevant to the expectations of customers. In summary, there are five key ingredients of proactive market orientation. They are the firm's strategic emphasis on marketing, its entrepreneurial culture, organizational slack, the firm's strategic flexibility and latent needs fulfillment. The measurement of proactive market orientation is resulted by the first empirical test of proactive market orientation (Narver, Slater, and MacLachlan, 2004).

2.5 Conceptual framework

According to the literature review provided, it is cleared that the framework, which is derived from the review on the theories, concepts, and the elements as entailed in the proactive market orientation, organizational culture as well as business performance, has been created to look into proactive market orientation practices of large-sized hotels performance and the moderating effects of organizational culture on business performance. The overall framework shows the relationship between proactive market orientation, organizational culture and business performance. While the independent variable in the framework represents proactive market orientation, the dependent variable is business performance. Organizational culture serves as the moderator variable between proactive market orientation and business performance.

3. Scope of the Study

The study focuses on proactive market orientation, organizational culture and business performance of the large size hotels in Thailand. The main objective requires data collection from questionnaires distribution to the director of sale or managers or senior executive of four stars and five stars hotels in Thailand.

4. Contribution of the Study

This study makes contributions to the field of hospitality. There have been many studies about market orientation, for instance, those that were conducted by Jaworski & Kohli (1993), Narver & Slater (1990), Pelham & Wilson (1996), Srinvasan, Lilien and Rangaswamy (2002), and Narver et al. (2004) it has been proved that there is a close relationship between market orientation and organizational performance. However, the marketing literature has not mentioned the disagreement or controversial thoughts between market orientation and organizational culture yet (O'Cass and Viet Ngo, 2005). And also proactive market orientation that using in this study still be limited empirical testing as noted by Naver, Slater, and MacLachlan (2004), however, noted that proactive market orientation has yet received not enough theoretical attention and extremely limited empirical testing and using proactive market orientation in marketing management can help it better understand the customer.

In addition, organizational culture, particularly a methodical and practical examination to be made in the service sectors is still imperfect (Webster and Sundaram, 2005). Therefore, the second contributions of this study will explain the affect of organizational culture between the relationship of proactive market orientation and business performance in large size hotels in Thailand, as stated by O'Cass and Viet Ngo (2005), the latent tension involving market orientation and organizational culture need to be ravel in the marketing literature. So, the body of knowledge of this study will be explaining the moderating effect of organizational culture on the business performance.

5. Conclusion

The research result will provide the in depth knowledge on the nature of proactive market orientation practices in large size hotels in Thailand as well as the moderating effect of the organizational culture towards business performance. This study, hence, will be widely beneficial for hotel executives, business operators, the Thai government, and the academic. To be more specific, the study will upgrade those people's knowledge and understanding on planning or market orientation management and the effect of organizational culture towards business performance in hotel businesses in Thailand. What is more, the knowledge gain in this study will help them make better decisions with finer strategies in the business competition for their organization's survival.

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An Analysis Business Ethics and Performance Management towards Sustainability Retail Traditional in Indonesia

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Abstract: Retail business is a business that has a high success opportunity in Indonesia. It is stated so as it is supported by the increasing customer needs and the shifting patterns of customer shopping behaviour. Since liberalization retail sector established in 1998 in Indonesia, the competition that occurs between modern retails does not only involve the local investors but also foreign investors. Therefore, the traditional retail business should be more sensitive in responding to competition and market changes if they want to keep exist in this competitive retail business. In order to give efforts to accelerate the existence of traditional retails, business ethics factors and managerial performance should be developed as the main strategy. A sample of this study is the traditional retailers who have been selected through judgment sampling method. A questionnaire is used to explore more on Primary data in order to identify and analyze the business ethics and management performance, including: procurement, capital, and marketing, toward the successful efforts in improving the welfare of the traditional family retail. The results of this research prove that business ethics has a positive and significant influence on management performance of traditional retail business. However, the influence of retail management performance against sustainability of traditional retail business highly depends on the marketing aspect as the most dominant influence. Understanding the human aspects of business ethics and managerial skills are important elements in achieving sustainability of traditional retail business as shown in the findings of this research.

Key words: business ethics; management performance; sustainability of traditional retail business
JEL code: M21

1. Introduction

Since the settlement of retail sector liberalization in 1998, the competition that occurs among modern retail in Indonesia has increased sharply (Kjeel, 2003). Traditional markets are the ones who receive the greatest impact of this competition. Some studies, on the impact of modern retail, were done in developing countries by Reardon and Berdeque (2002), Reador et al. (2003), Trail (2006) and Reardon and Hopkins (2006), found a negative impact on traditional retailers with the increasing number of modern retails.

The increasing number of luxurious and modern shopping centers in Surabaya and its surrounding areas, especially those built privately, causes anxiety and concerns among traditional merchants. The number of modern

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markets in Surabaya is bigger than traditional markets. At least 65% shopping centers in Surabaya are dominated by modern markets, either by factory outlets, supermarkets, mini markets, department stores and malls as published in Kompas Jatim daily newspaper (January 13, 2010).

The number of modern markets only 27% of the total Indonesian markets (more than 500,000 units) with a growth rate reached 31.4% per year. However, this type of markets fights over market value in spending money of a larger community than the traditional market of 98 billion U.S. dollars. Due to an uneven competition, many traditional retailers closed down their businesses (Bisnis Indonesia, 2010).

The effect of this closed down traditional retail can be seen through the number of people losing their jobs. *Image* as an employment provider which established by modern foreign retailers were not proven. The results of UK National Retail Planning Forum research mentioned that the presence of a new supermarket can cause the loss of 276 full-time jobs. *Image* as the access of local suppliers is also blamed by the conditions created by the major retailers themselves. A Research conducted by The University of Missouri found out that around 50%-75% of total net profits of the large modern retailers are not derived from sales of real products but from the costs imposed on the showrooms manufacturers and exhibitions (displays).

On the other hand, although traditional retailers do not offer comfortableness and is even known as wet markets, they are able to contribute 69.9% for national sales. Unfortunately, the contribution made each year has shown a decline in the number of sales in line with modern market. This happens because the growth rate of traditional retail reaches -8.01% per year while the traditional retail market share on average decreases 40%. The number of traditional markets from year to year also decreases. In 2010, the number of traditional markets reached 1,899,736. But in 2003, the traditional market fell by 154.147 units to 1,745,589 units. Nevertheless, the value of money spent by households in Indonesia to be spent on traditional markets reached 24.5 billion U.S. dollars per year. This amount of money is being contested by the traditional market of 1.7 million units. This market is also able to absorb 165 million consumers (Bisnis Indonesia, 2010).

Table 1 Labor Absorbed in the Retail Sector

Labor Absorbed in the Retail Sector 2005-2010						
Information	Amount (thousand)					
	2005	2006	2007	2008	2009	2010
Labor	13.245,8	13.574,9	13.975,8	14.550,0	14.955,7	15.539,2
% vol growth.	-	2.5	3.0	4.1	2.8	3.9

Source: Central Statistics Agency (BPS), an interview with Euro monitor International estimates.

The 220 million Indonesia populations can be a great and potential consumers and retail markets. Meanwhile, thousands of UMKM (Usaha Kecil dan Menengah) or SMEs (Small and Medium Enterprises) in this country also need access to the retail sector as a market to sell their products. In addition to these contributions, the retail sector in 2010 is also capable of absorbing 16% of the total workforce in Indonesia or around 16 million people. This absorption rate is likely to increase every year.

The existence of traditional retailers should be maintained, considering that there are some negative effects of dominant modern retail developments: (1) the presence of modern retail has blocked small local suppliers. The number of UMKM or SMEs that supplies modern retail is reaching 67% of the total number of suppliers, but the products supplied by UMKM or SMEs only is 10% of the total goods sold in a modern retail. This happens because the terms required by the modern retail UMKM or SMEs are too heavy to be fulfilled judging from its

weaknesses. (2) Another problem is the impact of modern retail toward local economy condition. In relation to the financial operational of the district area, most of it is a contribution from the activities of SMEs and traditional retailers with the amount contributed about 70% of total national sales in 2004. However, the less the number of SMEs and sale of traditional markets due to the closure of access or the incapability of competing with modern retail, the less contribution they make (Novery, 2006).

Thus, the existence of traditional retailers should be maintained. But the traditional retail business must be aware in responding to the unmet needs of customers (un met need) if they want to survive in this competitive retail business (Utami, 2007). Changes and developments of markets have demanded retailers to change the old paradigm of traditional retail management towards modern one. The most important in traditional retail paradigms is to run a retail business by applying distribution function. It means that sales actualization transaction as the main purpose needs to be changed with a more modern retail paradigm focusing on how retailers can meet the basic needs as well as additional requirements in its function as an intermediary (Utami, 2006).

A better understanding of modern retail management concept is crucial if small and medium retail business still want to survive. By running traditional retail, it is not possible to have a sustainable competitive profit when faced to numbers of modern retailers that are managed professionally or even as a result of the changing patterns of consumer spending. That is why, a better understanding of modern retail management concept is very important to be understood by traditional retailers, so does the aspect of good business ethics which inspired traditional retailers in business. Being aware of conducting retail business ethics should be interpreted as meaningful activities for yourself and your environment (ethics on consumers, competitors, suppliers, government/regulator) with a high motivation to improve the quality of personal life. Having only traditional retail management is not possible anymore to keep a sustainable competitive profit when we are faced to numbers of professionally manageable modern retailers and the changing patterns of consumer spending.

Formulation of the problem that can be presented in this study is: Does business ethics have relationship with sustainability of traditional retail business with management performance as mediator?

Based on the background of problems and formulation of the problem, the research objectives can be formulated as following: to know and analyze the relationship between business ethics towards sustainability of traditional retail business with management performance as mediator.

2. Traditional Retail Paradigm

Traditional Retail Paradigm emphasizes on the usage of the conventional and traditional approaches in retail management. Through the paradigm of conventional and traditional approaches, retail business is managed in such ways that more emphasis on “what can be prepared by employers, but less attention on how the needs and desires of consumers to be understood and even fulfilled” (Utami, 2010, p. 14). In Table 2 there are differences in the management paradigm of traditional and modern retail management paradigm.

Nowadays, it is expected that there will be shift of traditional retail paradigm into modern retail paradigm. Even though, small-scale retailers are often limited in terms of finance (funding) and the scope of its target market, but they have the ability to survive and develop into medium and even large-scale retailers.

Table 2 Paradigm Differences in Traditional and Modern Retail Management

Traditional Retail Paradigm	Modern Retail Paradigm
Less selecting Location	Site selection is considered
Does not account for potential buyers	Potential buyers continue to be predicted and evaluated
Types of merchandise are not directed	Types of merchandise focused and tailored to the target market
There is no brand selection	Strict selection of brand merchandise
Less attention to the supplier	Conduct rigorous selection of suppliers
Recording of sales is very simple	Sales are recorded and studied
Profit per product is evaluated	Profit per product is evaluated to determine the retail mix strategy
service the debt	Sales by cash/credit card
Less attention to the efficiency	Very concerned about the efficiency
Cash flow (cash flow) is not planned	Cash flow (cash flow) is planned
Finance mixed with the family finances	Separate financial clear with the family finances
Unplanned business developmen	Business development planned

Source: Utami, 2010, p. 16.

3. Retail Business Ethics

Doing business ethics that based on values only happens when there are changes of attitude in every businessman. This kind of attitude is determined by the mentality and mindset of each businessman. So seminar, workshop or training motivation is not easy to change one's mindset, because the mindset is the result of experience, beliefs, values that have been internalized and is believed by someone, which affects someone's behaviour and action. Being aware of business ethics should be started by conducting business as a meaningful activity for yourself and the environment (ethics on consumers, competitors, suppliers, government/regulator) with a high motivation to improve the quality of personal life.

Some ways to create business ethics: (1) awareness-raising process that includes the theme: judging from human life line in this world, it is only temporary. For that reason, how people make use of this life that only lasts one period. Therefore, we need to understand the orientation and business objectives such as society's welfare as the starting point of all. (2) the discussion of business ethics formation in order to see the process of characters building, mind set, emotion and behaviour patterns. An understanding of this process helps to change and modify characters building of each business. (3) In order to make effective changes of these processes, it is necessary to discuss the five human psychological needs that could be the basic motivation for behaviour changes. (4) The technique for creating this ethics can be started by identifying the problem and initiating changes effectively. (5) Practical techniques in solving conflicts. To be able to apply these techniques, business ethics need to be done continuously especially to those businessmen.

Recently, a multidimensional approach representing ethical/moral judgments (or moral construals) using three related dimensions has demonstrated significant relationships with future intentions across a wide variety of ethically charged settings (Robin et al., 1997). Three moral philosophical dimensions underlie marketing actors' ethical perceptions: (1) moral equity; (2) contractualism; and (3) relativism. Moral equity represents the inherent rightness/wrongness, or perceived justice of some action. Contractualism represents potential violations of implied or explicit rules or promises. Relativism represents perceptions that some action is acceptable by traditional or sociocultural standards.

4. Management Performance

4.1 Management Performance of Marketing

The problems that are mostly faced by traditional retailers in an effort to expand their business is the lack of

marketing knowledge caused by the limited information, which actually is reachable by the traditional retail market besides its limited ability to provide products or services related to the wishes and needs of the target market. Marketing problems that occur primarily on a small scale of traditional retail as stated in Anonymous research (2003) is caused by many factors, namely: (1) Many competitors (53.77%), (2) Low price of sales (27, 40%), (3) market saturation (6.51%), (4) inadequate information (4.45%).

4.2 Management Performance of Financial

Urata of Adiningsih (2000) mentioned that there are many things that affect traditional retailers in obtaining capital sources, such as: lack of unbalance fund availability that can be accessed by traditional retail, high transaction costs of a quite complicated procedure that consumes time while the amount of fund disbursed relatively small, less access to formal financial resources, both by the availability of bank and the adequate information, high interest credits investment and capital, many of traditional retailers are not bankable.

5. Sustainability of Traditional Retail Business

Generally speaking, retail is related to sales of goods and services to the last customers. To accomplish this, the traditional retail runs on purchasing, selling, promoting, pricing, bulk breaking, warehousing/storing, financing and underwriting risks (Bittel and Ramsey, 1985). If the traditional retails can run on these functions efficiently, then they will have a successful business.

To Measure whether business ethics success or not can be seen from the performance effectiveness and performance efficiency. Measured Performance is performance to be achieved by the business manager. In other words, business success can be measured by whether the purposes can be achieved or not, while every business has set variety of purposes. Therefore, the benchmarks used also vary but basically is the occurrence of an improvement on the goals set.

6. Theoritical Framework

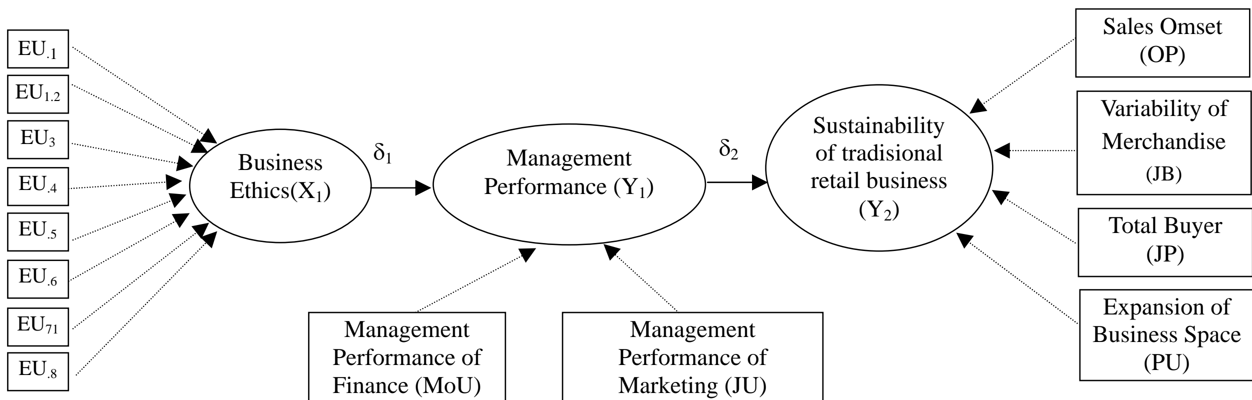

Figure 1 Theoritical Framework of the Study

Based on the objective of this study is to know and analyze the relationship between business ethics towards sustainability of traditional retail business with management performance as mediator, the above theoritical framework was developed (Figure 1). The instrument used was adopted from Paulraj, Antoby (2011) earlier related study.

7. Methodology

7.1 Sample and Data Collection Method

The number of samples is 67 traditional retailers who have a business in the retail district and is located in Gresik (East Java). A structured group-administered questionnaire using 5-point Likert scale was used in assessing the retailers experiences and feedbacks. By considering the purpose of research, the sampling technique used was disproportionate stratified sampling judgments. The reason for using disproportionate method (non-proportional) is referring to the opinion Subiyanto (2000, p. 97) which states that non-proportional sample (disportional) also made possible by reasoning/excuse, that is not necessarily members of the population in each strata can represent the interests/objectives of research overall. This is because the information required in an investigation cannot always be found in all strata of society.

7.2 Instrumentation

The main instruments used in this study is a questionnaire that is a structured list of questions used to measure the perceptions of respondents and the facts relating to the respondents, and with a condition that has been known to respondents. Filling the questionnaire by the respondents was accompanied by a qualified researcher to help interpret questionnaire questions correctly.

8. Finding and Discussion

8.1 Validity and Reliability Analysis

8.1.1 Test of validity

To ensure that the data in this study is valid and reliable, it needs to be done validity test. Based on data lamdha coefficient (loading factor) (see Table 3) of the overall variable was all indicators $\alpha \leq$ t table or $p \leq 0.000$.

Table 3 Loading Factor Research Variable

Var. Indicator	Loading Factor	CR(t count)	p	Information
EU_1	0.501	3.903	0.000	Significant
$EU_{.2}$	0.181	3.046	0.002	Significant
$EU_{.3}$	0.252	6.041	0.000	Significant
EU_4	0.226	0.949	0.003	Significant
EU_5	0.544	3.562	0.000	Significant
EU_6	0.401	4.114	0.000	Significant
EU_7	0.209	4.440	0.000	Significant
EU_8	0.663	5.239	0.000	Significant
OP	0.709	*	0.000	Significant
KB	0.900	7.517	0.000	Significant
JP	0.900	8.359	0.000	Significant
PU	0.899	*	0.000	Significant
MoU	0.708	*	0.000	Significant
JU	0.210	*	0.000	Significant

8.1.2 Test of reliability

This test was conducted to determine the internal consistency of the indicators a construct that indicates the degree to which each indicator is to identify a construct or latent common factor, or in other words how specific

things to help each other to explain a common phenomenon. The approach used is to assess composite reliability and variance of the construct extracted of their respective constructs.

Table 4 Test of Reliability Research Variables

Indicator Variable	Estimation (loading)	Loading^2	Measurement Error 1- (Loading)^2
EU_1	0.501	0.251001	0.748999
$EU_{.2}$	0.181	0.032761	0.967239
$EU_{.3}$	0.252	0.063504	0.936496
EU_4	0.226	0.051076	0.948924
EU_5	0.544	0.295936	0.704064
EU_6	0.401	0.160801	0.839199
EU_7	0.209	0.043681	0.956319
EU_8	0.663	0.439569	0.560431
OP	0.709	0.502681	0.497319
KB	0.900	0.81	0.19
JP	0.900	0.81	0.19
PU	0.899	0.808201	0.191799
MoU	0.708	0.501264	0.498736
JU	0.210	0.0441	0.9559
Jumlah	7.303	4.814575	9.185425

$$Construct-reliability = \frac{(\sum Std\ \ Loading\ )^2}{(\sum Std\ \ Loading\ )^2 + \sum \in j} = \frac{(7,303)^2}{(7,303)^2 + \ (9,185425)} = \mathbf{0.853}$$

Based on the above defined formula-construct reliability of research variables is 0.853, while the limit value that is used to assess an acceptable level of reliability was 0.70. Thus all the research variables are reliable indicators of significant and can be used for further analysis.

8.2 Descriptive Statistics and Analysis

While Figure 2 below shows the path coefficients influence business ethics, management performance, and sustainability of traditional retail business.

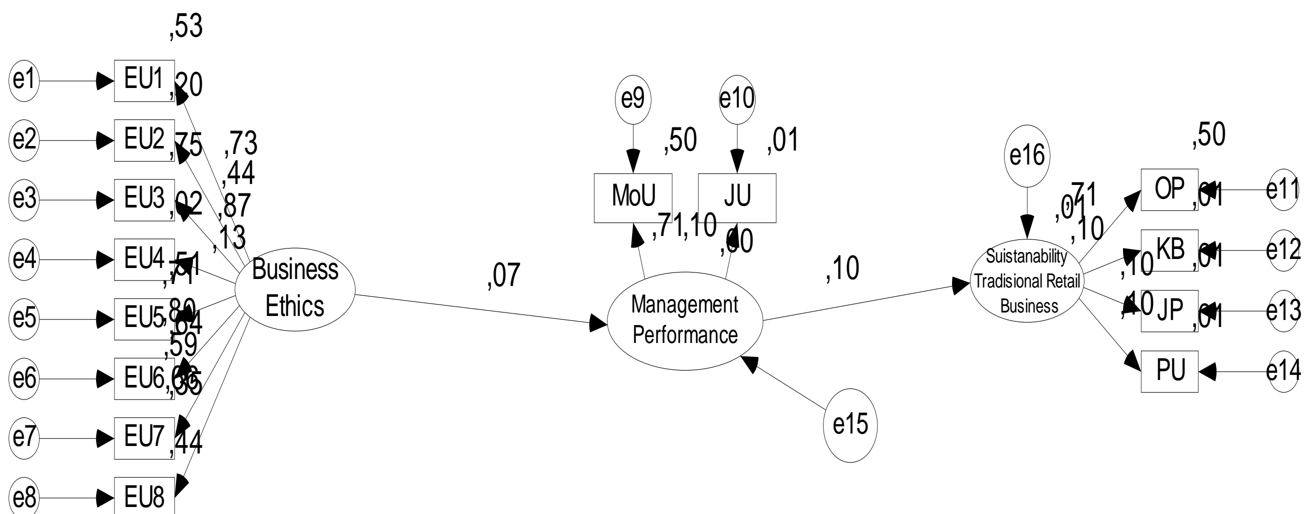

Figure 2 Research Model

To test the hypothesis will be presented following the path coefficient of relationship between variables used in the study. Path coefficients can be seen in Table 5 below:

Table 5 Path Coefficient, Cr and Probability Test Results of Significant Variables

Variable	Path Coefficient	Standard Estimation	Standard error	CR	Prob (p)	Information
Business Ethics→Management Performance	0.007	0.061	0.301	4.114	0.000	Signifikan
Management Performance→ Sustainability traditional retail business	0.010	0.0345	0.454	3.562	0.000	Signifikan

AMOS calculation results are presented in Table 5 show that business ethics has a relationship with, management performance. This is seen from the positive path coefficient with CR values of 4.114 obtained significant probability (p) equal to 0.000. This value is smaller than the significance level (α) is 0.05α. Thus, the research hypothesis which states that management performance has a relationship with sustainability of traditional retail business is accepted.

Table 4 shows that Management performance has a relationship with sustainability of traditional retail business. This is seen from the positive path coefficient with CR values of 3.562 obtained significant probability (p) equal to 0.000. This value is smaller than the significance level (α) is 0.05α. Thus, the research hypothesis which states that management performance has a relationship with sustainability of traditional retail business is accepted.

9. Conclusion and Future Recommendation

The first finding in this study is the business ethics awareness activities, just like the awareness of that ethical values in conducting business or business retailer should be aware to carry out activities of a significant or meaningful for themselves and the environment (ethics on consumers, competitors, suppliers, government/regulator) along with the motivation to improve the quality of personal life. Whereas business ethics have a significant and positive impact on performance management, in line with the research findings of Babin et al. (2004), which states that traditional retail business ethics is related to evoke in the retail-selling. This finding indicates that consumers respond to a similar retail business to business buyer upon perceiving the salespeople are acting opportunistically (Smith and Barclay, 1997). It means that business ethics on consumers, competitors, supplier, regulator/government will affect the achievement of the performance of the field in developing capital management and marketing or business network.

The second finding in this study is the performance management has positive and significant impact on the sustainability of traditional retail business. These finding is supported by the research of You, 2011 stating that the Performance Management is a key element in the achievement and sustainability of the business especially small businesses. Hansen et al. (1999) argued that firms should have personalization approach to create an effective performance management system. Thus, the performance of good management is an important factor in achieving sustainability of the traditional retail business. Whereas traditional retail business continuity can be done through the study of the average sales turnover, number and completeness of the goods, the number of buyers, the expansion of business space and average profit.

The third finding in this study is the performance management as mediator the relationship between business ethics towards sustainability of traditional retail business. This finding is supported by the research Liao (2006), argued that there are relationship between business ethics towards sustainability firm with performance

management as mediator. The general conclusion from this study is that business ethics approaches offer the most potential as a basis for improving business sustainability through Management performance.

The research findings can be used as a basis in conducting further research that related to deeper exploration of the culture or the human elements that can be variably antecedent of traditional retailers and business ethics research on the existence of traditional retail strategy in Indonesia.

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Market Competition and Performance of Tanzanian Manufacturing

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Abstract: The paper analyses the impacts of market competition on performance of firms in developing countries. The critical empirical question addressed by the paper is the question 'Why competition has not boosted firm level performance?' The paper addresses the questions by using panel data to estimate productivity effects of competition controlling for firm fixed effects and other determinants of productivity. Estimates of a Cobb Douglas production function. Competition is measured using the Hirschman-Herfindahl Index (HH) as competition variable indicates that 1 percent increase in competition results into 0.4 percent increase in productivity. However, the results are not robust when GMM and Fixed effects estimates are applied suggesting; biasness of OLS estimates and the fact that more productive firms are likely to self select into more competitive firms. Furthermore, the results indicate a positive correlation between firm specific characteristics with competition which influence profitability. Major conclusion of the paper is that there are broad ranges of micro level characteristics that influence firm performance that are not entirely addressed by macro level reforms including competition. Policy actions to tackle down are needed before we can expect trickle down to materialize.

Key words: Herfindahl; competition and firm level productivity
JEL codes: D43, L22

1. Introduction

This paper analyses the impact of competition on firm level productivity in Tanzania Manufacturing. The backdrop for this analysis is the persistent low level of development of manufacturing sector despite comprehensive economic reforms launched over two decades ago. This is a puzzle because some sectors such as mining and tourism have shown impressive performance after taking advantage of reforms, whereas Tanzania manufacturing still lags behind. There are studies (see for instance Harding et al., 2005) which suggest that the Tanzanian manufacturing sector has failed to recover its pre-reform level of 1970s when manufacturing export had significant share to total exports. There are competition related factors which might explain the observed poor performance of the sector. Low productivity, inability to export, high competition in domestic market, inadequate infrastructure and inputs availability are among the major factors that inhibit performance of Tanzania manufacturing. In all these factors, productivity appears to have significant influence in determining the state of manufacturing performance. Thus, analysis of this paper will contribute knowledge to a major question of 'Why competition has not boosted firm level performance in Tanzania?'

The question is important because experience from other parts of the World provide strong evidence of

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positive effect of competition on firm performance and overall economic growth and development. The economic reforms introduced via Structural Adjustment Programs (SAP) and later on Economic Reforms Programs (ERPs), Poverty Reduction Programs and others all had some competitiveness goals to ensure that a competitive economy is attained by stimulating productivity. Specifically for manufacturing we expect that competition will enhance productivity of manufacturing firms. This is partly due to the fact that productivity influence key determinants of firm success especially skills intensity, entrepreneurships, on the job training, innovation and quality of goods and services. Most significant outcome of productivity increase can be reduced production cost, increased output and quality. Hence, productivity gains will be most beneficial to consumers if competition ensures that reduced costs or increases in quality are passed on to them.

The ultimate outcome of course being increased profitability of a firm. This is why several empirical studies of product markets and of deregulation provide strong evidence of the high level relationship between competition and productivity. In principal, there are three ways through which competition has proven to influence productivity; first within firm effect whereby firm specific aspects that influences productivity might be determined by trends in competition. In this respect competition places pressure on the managers of firms to increase internal efficiency (x-efficiency) several authors have indicated how such relationships hold. Based on such findings, it has been imperative to notice that competition enforcements such as regulation of the market is justified for effective marketing of goods and services and most important well functioning of the economy.

The second most important vehicle that competition can influence productivity is via stimulating innovation. Authors who have confirmed this relationship have indicated that innovation increases dynamic efficiency through technological improvements of production processes, or the creation of new products. However, the competition effect on innovation is not always positive and there are cases where competition does harm innovation. The possible circumstance when competition cannot result into innovation is when competition is very high. This is why there is a need to ensure optimal level of competition that cannot harm innovation process. Lastly, competition can influence performance of firms if de-regulations or liberalization of the product market result into reduced administrative barriers to entry, increased consumers driven competition through the choices they make. Consumer policy may empower consumers to drive competition, and therefore have productivity enhancing potential. In sum competition can be a driver of both efficiency and innovation. Both of these factors lead to enhanced productivity.

There are more explanations on the observed manufacturing performance and competition. The recent years have seen relevance of competition in the progressive dynamics of manufacturing sector of Tanzania. This was not the case prior to 1980s when competition played little role in most African economies including Tanzania. During that period it was contended that free trade did not allow true comparative advantage situation to develop due to differences between marginal social and marginal private costs. Based on this argument industrialization in most of the African countries was undertaken through highly protective industrial and trade policies particularly through the infant industry argument for protection. While there were some gains in industrialization, the general performance of inward looking protected industrialization programs was not very successful. High effective rates of protection resulted into monopolistic enterprises which were featured by high investments but with low rate of capacity utilization, falling value added and total factor productivity, over-reliance in government subsidies and generally inefficient industrial base in most of developing countries. The presence of a large state sector partly explained why many developing countries did not find it necessary to have a competition. Therefore, the paper argues that competition did not exist and would not have any effect on firm performance.

But, over three decades later what sort of industrialization suits Africa? Definitely economic liberalization and reforms introduce after 1980s points to an outward looking industrialization based on competitive regimes as the relevant industrialization. In Tanzania, the post reforms period has seen a reversal of trade and industrial policies. After the introduction of the reforms it is not difficult to see why the need for competition becomes crucial in a developing country like Tanzania. Specifically in Tanzania industries, trade liberalization is an important reform measure introduced and aimed at increasing market competition for manufactured products, and this may affect profitability, productivity and efficiency, all aspects that might also affect wages. In the absence of subsidization, increased competition will benefit some firms (productive, efficient and competitive ones) and harm some (less productive, inefficient and uncompetitive ones) through affecting their ability to pay wages and therefore affect their factor demand including labour. The long run reaction of such firms has been either to close down or restructure in line with the existing production environment.

Other measures undertaken in the product market that may directly or indirectly affect wages are: product price deregulation, sales reforms aimed at improved competitiveness through increasing incentives for efficiency, increased access to productive resources, abolition of non-tariff protection, and reduced tariffs aimed at reducing the cost of imported inputs shortage of goods. Previously Tanzania had a price control system whereby government controlled prices of 373 products categories including 1,134 product types (JASPA, 1982) and on top of that, exercised restrictive trade policy in the form of quantitative restrictions, to protect both the infant industry and external trade balance. Tariff rates were also prohibitive ranging between "0 to 300[1]"(Mans, 1994). The reduction in trade barriers has led to increased importation of manufactured products competing with domestic manufactured ones. The general performance of the manufacturing sector in Tanzania has not been very satisfactory three decades after reforms.

In sum, there were expectations that macroeconomic success gained after the reforms would trickle down to micro level and stimulate growth in areas like manufacturing and enhance welfare growth of Tanzanians. Whether that has materialized is one of the questions that preoccupy most of the analysis presented in this paper. Furthermore, there are emerging questions and the popular one is "Why poverty has not declined as fast as attainment of macro level performance such as low rate of inflation and stable economic growth?" This paper contributes knowledge in this area by investigating what might be lacking at micro level, by comparing competition and firm performance. The paper does so by using various measures of firm level performance to examine whether and to what extent have such measures been influenced by the reforms.

The single measure of reforms used in change in degree of competition induced by the reforms. Estimates of a Cobb-Douglas production function that treat competition as one of the regressors are used to check if there is any significance correlation between competition and productivity. The estimates utilizes panel nature of the data available over the period 2000 to 2008 to control for firm specific characteristics that may potentially bias such firm level estimates. Competition is measured using the Hirschman-Herfindahl Index (HH).

2. An Assessment of Trends and Performance of Tanzania Manufacturing

2.1 Overview and Current Performance

Tanzania's manufacturing sector is one of the smallest in the East and Southern Africa region (EAC, 2009; DBSA, 1997). The major industries are food processing, textiles, metal, cement, fertilizer, and vegetable oil and

[1] The bulk of imports were subject to tariff rates of 0, 25 and 60 percent. There were other 15 rate ranging between 15 and 200 percent.

wood products. The most recent information on manufacturing performance shows that in 2009, the value of exports of manufactured goods decreased by 24.9 percent to USD 497.6 million from USD 662.3 million in 2008. The value of manufactured goods exported particularly cement; cooking oil; metal and copper products decreased due to fall in demand in the neighboring countries as a result of global financial crisis. However, the value of tobacco exports increased to USD 5.3 million in 2009 from USD 1.8 million in 2008. The exports of manufactured goods accounted for 23.0 percent of total nontraditional goods in 2009, compared to 29.2 percent in 2008. The growth rate in manufacturing sub activity was 8.0 percent in 2009 compared to 9.9 percent in 2008. The lower growth rate was attributed to decrease in the production of exported goods following the impact of the Global Financial Crisis. However, production of some items such as food and dairy products, chemicals, and printing increased. The contribution of manufacturing to GDP in 2009 was 8.6 percent, compared to 7.8 percent in 2008.

The production costs increased from shs 1,747,351 million in 2008 to shs 1,764,351 million in 2009, equivalent to an increase of 1.0 percent. The increase was due to rise in the production cost of food, beverages, tobacco, cigarettes and chemicals. The current performance is an improvement from the previous state. It will be recalled that prior to the 1990s the sector was dominated by state owned firms. These were either acquired through nationalization introduced in February 1967 or established through government industrial development projects. Import substitution was the dominant industrial strategy. Initially the sector generated significant growth especially in the 1970s, but from the late 1970s this growth halted. It is estimated that by 1986 output was at only 30 percent of its 1979 level, with the share to GDP falling from 12 percent in the 1970s to 8 percent in 1980s. Following major economic reforms adopted in 1986, the manufacturing sector has been subjected to substantial re-structuring aimed at increased capacity utilization; export promotion, attraction of private sector (both foreign and domestic), investment increased competitiveness and overall efficiency. During the period from mid 1980s to 2010 the manufacturing sector begun to recover. Its GDP contribution during the 1986-1991 increased by 23 percent, growth in real manufacturing recovered from negative and was positive each year starting from 1987, with manufacturing output growing faster than total GDP (Mans, 1994 and URT, 2011). The GDP contribution of manufacturing has remained relatively small at between 8 and 9 percent.

2.2 Trends in Productivity Growth

The productivity trends in Tanzania matches in three phases that can be said to reflect three periods of development in the post-independent Tanzania namely: a period of expansion, 1974-1980, a period of collapse 1981-1990 and a period of adjustment, privatization and re-structuring, 1991-2000s. It will be recalled that after the introduction of rural development policies that contained the population under community village settlements, nationalization, Import Substitution and Basic Industrialization Strategies the Tanzanian manufacturing sector became a fast-growing sector. However, rapid expansion particularly in the 1960's and 1970's was followed by a collapse in the early 1980's. War with Uganda, extensive periods of droughts, failure of crop production especially sisal, inefficiency due to high protection in the form of tariffs and non tariffs instruments, scarcity of foreign exchange, excessive state involvement in industrial production (including subsidization), anti export bias are among possible factors, why the collapse was very severe.

The production of goods, which were formerly imported, was accompanied by imports of capital goods and intermediate inputs. Two implications of this phenomenon may be identified. First the desired production levels could only be maintained if the productivity of the import substituting industries was high enough to generate foreign exchange to facilitate importation of inputs. Secondly, the import substitution industrialization objective could be realized if, foreign exchange saved by producing manufactured goods was high enough to cope with the

requirements of imported inputs to keep industry operating at the desired levels. In connection to that, the collapse of manufacturing production intensified during the period of economic crisis.

Furthermore, trends in real output over the period from 1990 to 2010 are declined followed by some recovery in certain years. The pattern of value-added growth shown by the official statistics is very broadly similar to that for output in that there was a decline from 1990 to 2000 and then a recovery. These result showing a recovery are based on the large and medium sized firms covered by the industrial survey, thus there is a question as to how representative they are of the whole sector. It is apparent that Tanzania's share in the world market is negligible and has been declining both in real terms and as a proportion of output. One objective of the trade and financial sector liberalization, which has been implemented since the 1980s, is to encourage manufacturing firms to operate in a more competitive environment so as to enhance their efficiency and productivity.

Following major economic reforms adopted in 1986, the economy has been subjected to substantial re-structuring aimed at increased growth capacity utilization and overall efficiency. The level of human capacity has been subjected to securitization and emphasis to raise availability of qualified manpower. The increased access to education in all levels is one of the major pre-occupations of Tanzania development policies expected to enhance, development. The empirical question now is what causes the observed increase in productivity after 1990s? The contribution of this paper is to addresses the question by testing if higher education has any role to such observed trends in productivity.

There was certainly an expectation that after the reforms local firms would hold their market share and increase exports. On the basis of the official statistics there is no basis to believe that expectation has been met.

2.3 Empirical Literature on Productivity of Tanzania Manufacturing

The most extensive study in this area of productivity was conducted by Professor Amon Mbele in 2005. His study investigated productivity performance in Tanzania, with the growth of the overall economy as the main focus. He used growth accounting, to assess the contributions of physical capital, labor and Total Factor Productivity. His findings were that Tanzania experienced growth in labor productivity and Total Factor Productivity for the whole period. There was high capital deepening during 1967-1985, compared to the reform period 1986-2000. If the record of growth is reflected on, this means that capital was less productive during 1967-1985. For the period 1986-2000, labor productivity growth declined marginally by 0.4%, while Total Factor Productivity growth was highest, implying that the impressive growth performance during 1986-2000 can be associated more with growth in Total Factor Productivity.

The detailed literature review on productivity is provided in UNIDO country case study of 2005. Ndulu and Semboja (1994) investigated productivity, efficiency and export performance in the manufacturing sector in Tanzania. Productivity was assessed in terms of domestic prices. Three measures of efficiency were used: partial factor productivity, a modified measure of labor productivity and a simple measure of investment productivity. The authors found variations in output to be totally explained by changes in factor inputs and that productivity growth in the manufacturing sector was statistically insignificant. This was explained partly by the cyclical instability of actual production. The large fluctuations in labor productivity were mainly influenced by output variations. In terms of efficiency, about 40% of manufacturing activities generated negative value-added. Further, they found the incentive structure during the first half of the 1980s to be grossly biased against exports (the real official exchange rate, commercial policy instruments such as quantitative restrictions and related exchange controls which served as explicit and implicit taxation of exports). It was only during the latter part of the 1980s that exports started to pick up as a result of the various measures instituted, such as real currency devaluation,

export promotion measures, reduced anti-export bias and the streamlining of export procedures.

Szirmai et al. (2001) investigated manufacturing performance in Tanzania using time series analysis. The International Comparisons of Output and Productivity Project (ICOP) methodology was used, with comparative US labor productivity as a benchmark. In general the authors found a large productivity gap between the US and Tanzania and attributed this to the vast technology gap between the two economies. Using 1976 as the base year, the authors traced trends in labor productivity. There was a rapid initial increase after 1965, reaching a peak in 1973 and later declining steadily throughout the 1970s and 1980s, probably due to continued retention of workers when output was declining. By 1990 the level was half that of 1973.

Micheline Goedhuys; Norbert Janz; Pierre Mohnen (2008), using cross-sectional firm-level data, examines the determinants of productivity among manufacturing firms in Tanzania. In particular, they seek to evaluate the relative importance of technological advances and the business environment in which firms operate in affecting productivity. Of the technological variables, R&D as well as product and process innovation, licensing of technology, and training of employees fail to have any impact; only foreign ownership, ISO certification and higher education of the management appear to affect productivity. Some important influences from the broader business environment, however, appear to affect productivity and are robust to different specifications of the model. The study shows that credit constraints, administrative regulatory burdens and a lack of business support services depress productivity; membership of a business association is associated with higher productivity.

3. Conceptual Framework Theory and Literature

3.1 Theory and Conceptual Framework

Many theoretical models available for estimating competition aspects of manufacturing sector are based on principal agent model, in which the owners of a firm design incentive scheme for the manager, but the structure of the scheme depends on various factors including market competition. The models analyze how the optimal incentive scheme changes in response to the change in the extent of market competition. The definitions of competition are so diverse and, furthermore, the results rely on factors incorporated into these models. Not surprisingly, it is not theoretically evident whether the intensification of market competition would induce managers to exert more efforts. In spite of the ambiguity of theoretical predictions, empirical studies have tried to test the hypothesis that market competition would increase the efforts of managers, and thus lead to higher performance, including higher productivity. Empirically, the extent of competition has been captured by several variables; concentration ratio, above normal rent, market share and questionnaire based results.

3.2 Some Empirical and Theoretical Literature

There is a strong body of evidence that competition enhances productivity. Nickell, Nicolitsas and Dryden (1997) obtained the result that higher average rents normalized on value added tend to reduce productivity growth. Green and Mayes (1991) claim that the extent of competition is among the important variables that significantly explain the difference in efficiency other scholars claim that deregulation, which is expected to intensify competition, raises productivity of firms. For example, Olley and Pakes (1996) show that in telecommunications equipment industry in the US, productivity growth accelerated after the deregulation of the industry. Similarly, the positive impact of deregulation in transition economies was reported by Li (1997) for China, by Djankov and Hoekman (2000) for Bulgaria, and by Grosfeld and Tressel (2002) for Poland. Nickell, Wadhwami and Wall (1992) show that the increase in market shares of a firm reduces its productivity growth. The effect of turnover on

performance has been examined by, among others, Dunne, Roberts and Samuelson (1988), Baily, Hulten and Cambell (1992), Baldwin (1995), Baily and Gersbach (1995), Bartesman and Doms (2000), Aw, Chen and Roberts (2001). All of them indicate that the turnover plays a critical role in the increase in the productivity of industries.

The study by Haskel (1991) provides one of the first studies to exploit micro level data to explore the effects of competition on productivity. He uses UK panel data from 1980-1986 to investigate the role that changes in the product market have on productivity growth. He finds that high levels of market concentration and market share have an adverse effect on total factor productivity. Another study in this area was conducted by Nickell in 1996. In such study, the author examined competition in product markets also using micro-data. The study reports high rent firms had consistently lower productivity growth than low rent firms. Specifically the study report that a ten per cent increase in price mark-ups resulted on average in a 1.3-1.6 percent loss in TFP growth. Blanchflower and Machin (1995) measure competition as reported by participants in a market using data from the Workplace Industrial Relations Survey (WIRS). Their results prove largely inconclusive. Whilst they find a positive relationship between labour productivity and competition in Australian manufacturing, they are unable to show this result in Britain. These findings must be considered in light of the large amounts of subjectivity inherent in using management surveys to measure of competition.

Griffiths and Harrison (2004) provide a good overview of studies which explore this connection. The list below is indicative of the findings in the area. Ehrlich et al. (1994) investigate 23 international airlines with varying levels of state ownership. They estimate that complete privatization of an airline increases the annual rate of TFP growth by 1.6-2.0 percent on average in the long run. Boylaud’s (2000) analysis of the liberalisation of the road freight industry in OECD countries, and Olley and Pakes’ (1996) survey of deregulation in US telecommunications, both identified productivity gains. Similarly, Gort and Sung (1999) were able to identify TFP growth rates between seven and 14 times higher in competitive US telecoms markets than in regional telecoms monopolies, during 1985-1991. Nicoletti and Scarpetta (2003) find that product market regulation (PMR) slows down catch-up growth.

The theoretical literature on the effect of market competition does not clearly accord with this casual argument. One of the reasons for this is that there are various definitions of competition in the theoretical literature. Intensification of market competition is captured by, for instance: the change in the mode of competition, from monopoly to perfect competition (for example, Arrow, 1962) and from cartel to Cournot to Bertrand competition (for example, Horn, Lang and Lundgren, 1994); increase in the number of firms (for example, Loury, 1979; Lee and Wilde, 1980; Dasgupta and Stiglitz, 1980a,b; Reinganum, 1982, 1985; Spence, 1984; Martin, 1993; Krishna, 2001); the number of other managers to whom each manager is compared (for example, Holmstrom, 1982; Nalebuff and Stiglitz, 1983; Mookerjee, 1984; Hermalin, 1992); increase in the price elasticity of demand (for example, Willig, 1987); reduction of the size of demand (for example, Willig, 1987; Hermalin, 1992); decrease in profits (for example, Schmidt, 1997); increase in the substitutability between products (for example, Aghion, Dewatripont and Rey, 1997); reduction in the gap between a leader and a follower (for example, Harris and Vickers, 1987); forward movement towards goal by one of rivals (for example, Harris and Vickers, 1987); the increase in the ratio of entrepreneurial firms relative to managerial firms (for example, Hart, 1983; Scharfstein, 1988); existence of a potential rival (for example, Gilbert and Newberry, 1982; Nalebuff and Stiglitz, 1983).

3.3 Models Specification and Data

The empirical strategy of the paper is to investigate if measurable aspects of competition can explain observed changes in firm level performance. The most straightforward measure of performance is productivity. It

is important to note that in measuring productivity per labor the model estimated should display existence of constant returns to scale. This can be easily tested using appropriate diagnostic tests after estimations. The measure adopted for labor productivity is using log of labor productivity in *(Y/L)* is defined as real gross output per person hour. In principle Y and L are the total output and labor respectively. Total factor productivity is the most appropriate way of trucking changes in firm level performance after changes in the economic environment and structure in which a firm operates. Such measure can be easily obtained as a residual after estimating a gross output or net output productivity equation. Thus, stating from a production function model shown below:

$$\text{In} \quad InY_{it} = \alpha_K InK_{it} + \alpha_L InL_{it} + \alpha_M InM_{it} \tag{1}$$

Where InY_{it} is log of output;

InK_{it} is log of capital;

InL_{it} is log of labor;

InM_{it} is log of raw materials.

To assess the productivity effect of competition policy on the manufacturing sector, we estimate the production function as follows:

$$Q_t = A_t K_t^{\beta 1} L_t^{\beta 2} COM_t^{\beta 3} \tag{2}$$

Where COM is a measure of market power or competition.

This amounts to re specifying our equation 1 as follows:

$$\text{In} \quad InY_{it} = \alpha_K InK_{it} + \alpha_L InL_{it} + \alpha_M InM_{it} + \alpha\, \text{COM} \tag{3}$$

Nonetheless, it is important to note that estimates of the market competition using econometrics methods faces estimation problems. The effects of omitted variable, simultaneity and measurement error are observed in almost all variables. For, instance the major concern in applying OLS to estimate the competition effect is that, the disturbance term captures unobservable (omitted) individual effects that also might influence the firms performance or competition. Therefore, when estimating the impact of market competition on Tanzania firms, the precise measurement of the economic effect is plagued by difficulties in isolating the causal effect of competition and performance. There are a number of approaches available to deal with such econometrics problems. The use of survey data that combines both time and individual dimension is the most critical pre-requisite for the solution to the problem. Using such information it is possible to account for the time invariant unobserved effects that are likely to influence competition and performance and yet correlated with the error term. Data available for this paper has panel dimension. The paper uses such information to account for the major sources of endogeneity in this paper.

3.4 Data and Measurement Issues

The data used in this study is from the annual surveys of Tanzanian manufacturing firm surveys. These surveys are collected each year by the National Bureau of statistics using a country representative sample that covers all establishments employing five people and above. The data contains nearly 534 firms over five years from 2000 till 2006. The data was collected from various sources including Tanzania Manufacturing Surveys, Investment Climate and Annual Surveys of Industrial Production for the period 2001 till 2008. Rich panel data is obtained by combining unique firm specific identifier with information from the annual data. In the production functions presented using value added, we have excluded a small number of outlying values. These include negative value added observations, which tend to be associated with recent firm entrants or impending exits and

which do not represent the steady state performance of the firm in question. We also exclude observations where the ratio of value added to capital is greater than 50 or less than 0.01 since these are believed to be driven by measurement errors in these two variables, particularly the firm's physical capital stock (due for example to the use of tools or machinery which does not belong to the firm). The real capital stock series used here is based upon a firm's replacement value of plant & machinery which is augmented with subsequent investments in plant & machinery made by the firm during the period. We also allow for 5% depreciation per annum of per period capital stock. Other variables such as sales, raw materials, and intermediate cost are a direct reporting from companies on the cost incurred in such items during the period of one year.

3.5 Measure of Competition

In order to ascertain whether or not economic reforms in the market have been of any effect at the firm level, the paper uses measures of changes in market power as one of the explanatory variables in the Total factor productivity equation indicated above. In order to investigate changes in market power or concentration, we specify a concentration measure. There are a variety of indices that can be used. Most concentration measures are based on the shares of an individual firm. If we denote the number of firms in the sector as n and q represents the share of sales of an I firm at time t, then the sum of q from 1 to n will be q and the share of each firm in the market for a specified time period, say year t, would be expressed as:

$$P_{it} = \frac{q_{it}}{q_t} \quad \text{i=1 ,….., n and t = 1, ….., T}$$

The market share is then measured using either concentration ratio or Herfindhal Hirschman index (HH). Concentration ratios are measures of the total output that is produced in an industry by a given number of firms in the industry. The most common concentration ratios are the CR_4 and the CR_8, which means the 4 and the 8 largest firms. Concentration ratios are usually used to show the extent of market control of the largest firms in the industry. It is presented below as follows:

$$CR(k)_t = \sum_{i=l}^{k} p_{it}, \qquad k < m$$

Hence, the Concentration Ratio shows the percentage of market share held by the largest firms (m) in an industry.

$$CR_m = \Sigma^n_{i=I}\, x_i$$

Therefore it can be expressed as:

$CR_m = s_1 + s_2 + ... + s_m$ where s_i is the market share and m defines the ith firm

The other common index for measuring market power is Herfindahl index also known as Herfindahl Hirschman Index (named after Orrris C. Herfindahl and Albert O. Hirschman. It is defined as the sum of the squares of the market shares of the 50 largest firms (or summed over all the firms if there are fewer than 50) within the industry, where the market shares are expressed as fractions.

$$HH_t = \sum_{i=l}^{m} p_{it}^2$$

The result is proportional to the average market share, weighted by market share. As such, it can range from 0 to 1.0, moving from a huge number of very small firms to a single monopolistic producer. Increase in the Herfindahl index implies a decrease in competition and increase in market power of a few. On the other hand a fall in HH index value suggests an increase in competition and reduced power of a few firms.

3.6 Profit Function

The other model estimated empirically in this paper is a profit function. The analysis begins by considering operation of a firm after competition and relates its profit to a competitive regime. In particular we consider a competitive firm with the profit function that considers the difference between total sales and total cost.

4. Quantitative Assessment of Competition within Domestic Industries in Tanzania

4.1 Concentration in Tanzania Manufacturing Sectors

Overall, the level of competition is still limited among Tanzanian manufacturing industries. The most of the manufacturing sectors have are highly concentrated as reflected in concentration indices such as Herfindahl-Hirshman Index (HHI) and top 3 or top 4 concentration ratios (CR-3, CR-4). Based on 2007–2008 average, ISIC Group 2 (coke) is dominated by one firm and Group 29 (machinery and equipment), Group 33 (medical, precision and optical instruments, watches and clocks), Group 35 (other transport equipment) are also highly concentrated with top three firms in each industry occupy almost all production in each industry. ISIC Group 16 (tobacco products), Group 17 (textile), Group 18 (apparel), Group 19 (leather, luggage, footwear), Group 26 (other metallic mineral products), Group 27 (basic metals), Group 31 (electronic machinery and apparatus), Group 33 (motor vehicles) are also relatively concentrated. Only Group 15 (food products and beverage), Group 20 (wood products), Group 21 (paper and paper products), Group 22 (publishing and printing), Group 24 (chemical), Group 25 (rubber and plastics), Group 28 (fabricated metal products), Group 36 (furniture) show HHI less than 0.2. In all manufacturing groups except for food products and beverages, top 3 or top 4 firms in each group produce more than 50 percent of total production.

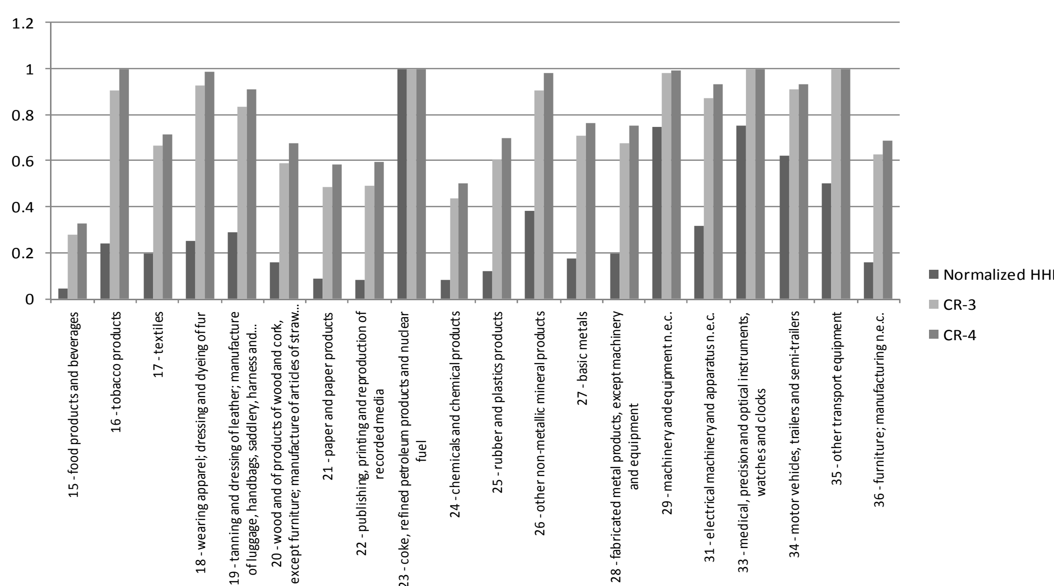

Figure 1 Normalized HHI, CR-3, and CR-4 of ISIC 1 Digit Industrial Groups in Tanzania: 2007
Source: Tanzania Annual Survey of Industrial Production

Although still concentrated in absolute term, the most of the manufacturing sectors have recorded decreases in concentration over time, particularly since 2001. With exceptions of textile (17), apparel (18), coke (23), other non-metallic mineral products (26), all manufacturing sectors in Tanzania have seen their levels of concentration

decreased between 2001–2002 and 2006–2007.

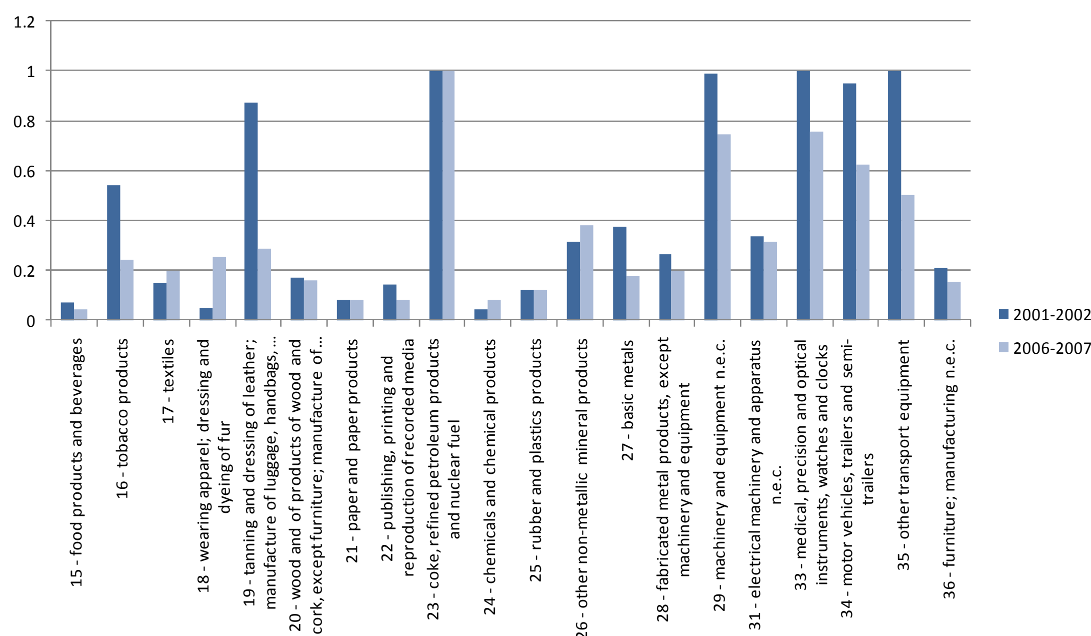

Figure 2 Normalized HHI: 2001-2002 Average vs. 2006-2007 Average

Source: Tanzania Annual Survey of Industrial Production

However, within more recent years, more industries have increased the level of concentration. In addition to the above three industries, tobacco (16), machinery and equipment (29), electronic machinery and apparatus (31), motor vehicles (33), and other transport equipment (35) have increased their levels of concentrations from 2004 to 2007. A similar pattern of increasing levels of concentrations can be also observed in CR-3.

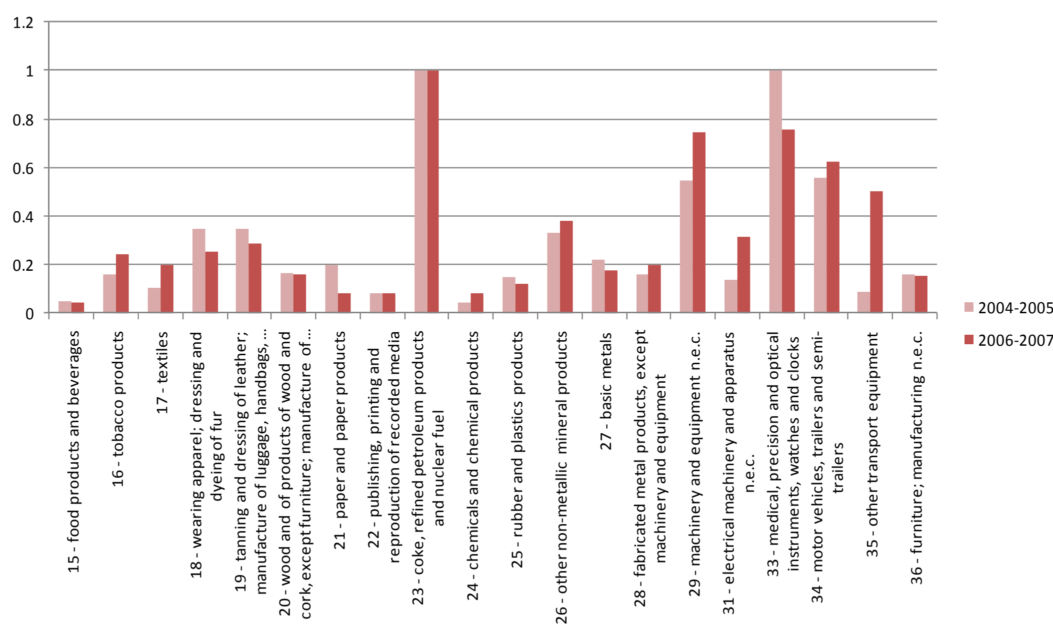

Figure 3 Normalized HHI: 2004-2005 Average vs. 2006-2007 Average

Source: Tanzania Annual Survey of Industrial Production.

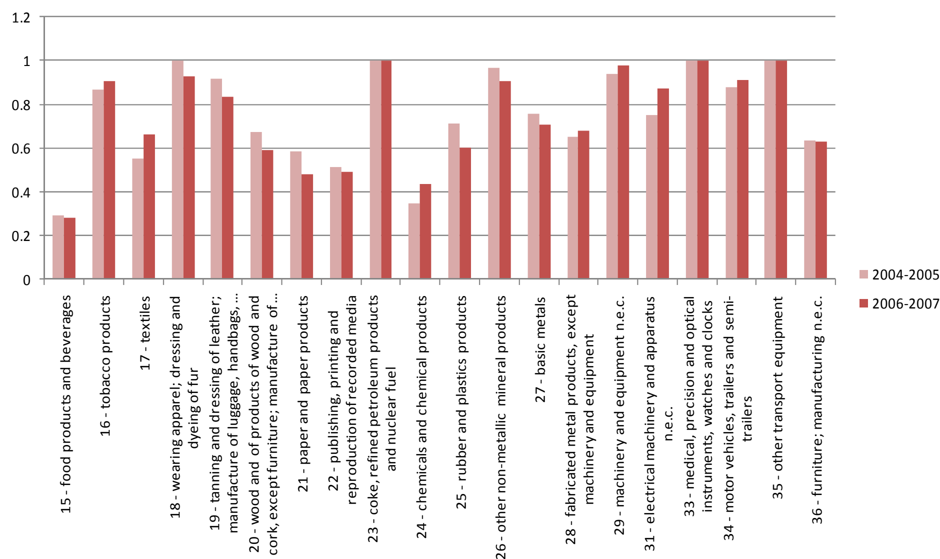

Figure 4 Top 3 Concentration Ratio: 2004-2005 Average vs. 2006-2007 Average

Source: Tanzania Annual Survey of Industrial Production.

4.2 Concentration and Productivity

The data show industries which reduced their levels of concentrations have become more productive. Measured by both sales per worker and value-added per worker, labor productivity has increased from 2004-2005 to 2006-2007 among those industries whose levels of concentration, either in terms of HHI or CR-3Level of concentration is inversely related to productivity. In fact, the less concentrated industries have become, the more productive they have become.

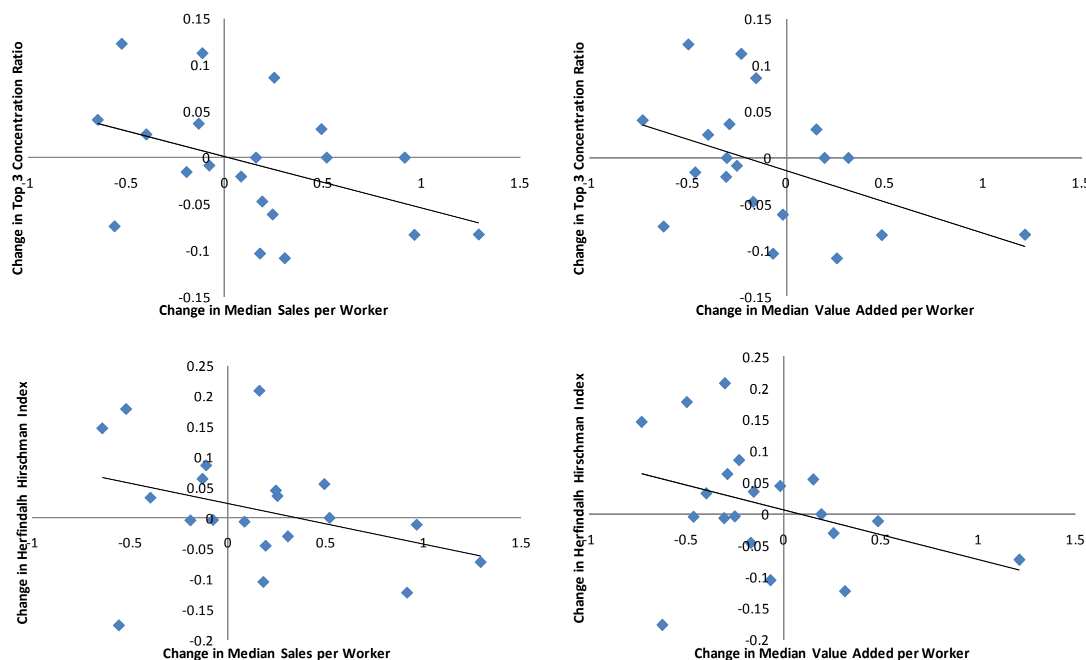

Figure 5 Changes in Concentration and Labor Productivity: 2004/05-2006/07

Source: Tanzania Annual Survey of Industrial Production.

5. Has Competition Enhanced Firm Level Performance in Tanzania Manufacturing?

It will be recalled that one of the major hypothesis tested in this paper is whether there is any evidence of positive correlation between competition and growth. The strategy of estimate is to assess the relation between competition and productivity. The results are presented in Table 1. The first and second column estimates our production function using Ordinary Least Square and panel data estimates of fixed effects and GMM. In the first column of the Table 1, we present estimates of the production function in which the competition variable measured using Herfindhal Hirschman is a proxy for competition. The results indicate a positive correlation between competition and productivity. In particular it is indicated that 1 percent increase in competition results into 0.4 percent increase in productivity. However, the results are weakly statistically significant. When the panel estimates are introduced the correlation between competition and productivity disappear. In particular, the fixed effects estimates and GMM estimates show that competition has no productivity effect among the manufacturing firms. The results suggest that OLS estimates reported in columns [1–2] are biased. In fact the firm specific characteristics or attributes have a lot to influence the observed competition effect. There is no causal relationship between competition and productivity except that more productive firms are likely to self select into more competitive firms. This partly address our question on why trickle down might be hard to observe when one start from macro-economic environment. Specifically, this is due to the fact that policy actions to address the weaknesses at firm level that influence productivity must be introduced to reinforce the effectiveness of the functioning of improved competitive environment.

There is a question on what determines the competition at firm level. Table 2 attempts to address such question. The results in this second table confirm that competition measured using market share HH index is influenced by the output per employee, exports intensity in input usage and firm size. However, when the estimates control for firm fixed effects it is only export that appears to have a strong positive correlation with competition. The implication of the results is that our estimates strongly support the hypothesis of export led growth as a way forward to strengthen performance of manufacturing sector of Tanzania. In Table 3 we carry further analysis of the link between competition and performance of manufacturing sector of Tanzania by assessing the profit effect of competition. The anticipation of the analysis is that if competition has been positive to influence firm behavior such as investing in more efficient production then profit must be positively correlated with competition. The OLS results indicated in the Table 3 shows a positive correlation between profit and competition in Tanzania manufacturing firms. The results are strongly significant suggesting that 1 percent increase in competitiveness measured by market share of firm results into more than 1 percent increase in profit. But when firm specific characteristics are controlled for, the results suggest no correlation between profit and competition. We discuss such findings that our OLS results are biased such that they pick positive correlation between omitted firm specific aspects with competition and ultimately profit. While in reality there are firm specific characteristics that are correlated with firm market share which also influence profit. It could for instance be the fact that companies that are well connected to reliable markets will sell more and also will be more profitable. Finally, the study assesses the impact of competition on total factor productivity of firms. The same strategy of estimating a production function is adopted here.

Table 1 Productivity Effect of Competition on Tanzanian Firms

Dependent Variable				
Log of output	OLS	OLS	F-Effect	GMM
Log Capital	0.076	0.076	0.076	0.073
	(6.68)**	(6.68)**	(6.73)**	(7.81)**
Log Labor	0.374	0.308	0.300	0.312
	(15.89)**	(11.75)**	(11.48)**	(10.17)**
Raw Materials	0.523	0.514	0.509	0.493
	(32.77)**	(31.35)**	(31.31)**	(44.25)**
Competition	0.418	0.422	-0.374	-0.197
	(1.50)	(1.52)	(0.50)	(0.28)
Exports		0.000	0.000	
		(2.39)*	(3.34)**	
Micro	0.493	0.486	0.500	
	(1.82)	(1.77)	(2.34)*	
Small	-0.327	-0.349	-0.364	
	(3.64)**	(3.88)**	(3.74)**	
Medium	-0.150	-0.151	-0.157	
	(2.48)*	(2.51)*	(2.34)*	
round1	-0.176	-0.188	-0.174	-0.197
	(2.37)*	(2.54)*	(2.35)*	(2.84)**
round2	-0.213	-0.226	-0.212	-0.236
	(2.85)**	(3.03)**	(2.85)**	(3.40)**
round3	-0.173	-0.174	-0.159	-0.177
	(2.43)*	(2.46)*	(2.24)*	(2.80)**
round4	-0.148	-0.151	-0.137	-0.155
	(2.01)*	(2.05)*	(1.87)	(2.42)*
Constant	2.985	3.487	3.535	3.675
	(22.62)**	(17.62)**	(17.85)**	(18.39)**
Observations	1926	1926	1926	1926
R-squared	0.81	0.82	0.82	
Number of firm	534			
Robust t-statistics in parentheses				

Note: * significant at 5%; ** significant at 1%.

6. Conclusion

The paper set out to analyses the impacts of market competition on performance of Tanzanian manufacturing. The backdrop for this analysis is the persistent low level of development of manufacturing sector despite comprehensive economic reforms launched over two decades ago. This is a puzzle because some sectors such as mining and tourism have shown impressive performance after taking advantage of reforms, whereas Tanzania

manufacturing still lags behind. The critical empirical question addressed by the paper was the question ‘Why competition has not boosted firm level performance in Tanzania?’ The analysis also indirectly addressed the most outstanding question of why poverty has not disappeared despite the impressive macro economic performance in recent years. The paper addressed such questions by using panel data to estimate productivity effects of competition controlling for firm fixed effects and other determinants of productivity. The specific estimation strategy involved estimates of a Cobb Douglas production function.

Table 2 Determinants of Competition in Tanzanian Firms

	OLS	OLS	F-Effects	GMM	GMM
Log Output/employee	0.003	0.005	0.001	0.001	0.000
	(1.32)	(1.68)	(0.36)	(0.21)	(0.35)
Log Capital/employee	-0.003	-0.005	-0.001	-0.001	0.000
	(1.81)	(2.05)*	(0.42)	(0.13)	(0.17)
Log Raw materials	0.001	0.001	0.000	0.000	0.000
	(1.52)	(1.57)	(1.29)	(0.35)	(0.53)
Log of Cost/Employee	0.000	0.001	-0.000	-0.000	-0.000
	(0.29)	(1.12)	(0.60)	(0.11)	(0.67)
Micro	-0.002	0.000	-0.000		
	(1.89)	(0.03)	(0.03)		
Small	-0.002	-0.000	0.000		
	(2.23)*	(0.08)	(0.23)		
Medium	-0.001	0.001	0.001		
	(0.44)	(0.65)	(0.69)		
Exports	0.000	0.000	0.000		
	(2.58)**	(13.72)**	(3.12)**		
round1	-0.010	-0.010	-0.008	-0.007	
	(2.12)*	(2.12)*	(1.84)	(3.42)**	
round2	-0.010	-0.010	-0.008	-0.007	
	(2.12)*	(2.12)*	(1.85)	(3.41)**	
round3	-0.010	-0.009	-0.007	-0.007	0.000
	(2.18)*	(2.17)*	(1.90)	(3.51)**	(0.78)
round4	-0.010	-0.009	-0.007	-0.007	
	(2.17)*	(2.17)*	(1.90)	(3.60)**	
Constant	0.004	0.003	0.006	0.006	0.001
	(1.61)	(1.17)	(1.58)	(1.24)	(13.10)**
Observations	2032	2032	2032	2032	2032
R-squared	0.3	0.23	0.30		
Number of firm		534			
Robust t-statistics in parentheses					

Note: * significant at 5%; ** significant at 1%.

Table 3 The Impact of Competition on Firm Level Profit

Variable	OLS	OLS	GMM	F-Effects
Log Capital	0.077	0.077	0.078	0.075
	(5.54)**	(5.55)**	(5.65)**	(6.34)**
Log Labor	0.417	0.369	0.355	0.363
	(14.42)**	(9.42)**	(9.13)**	(9.38)**
Log Raw Material	0.321	0.315	0.308	0.295
	(17.44)**	(16.75)**	(16.74)**	(20.99)**
Competition	1.038	1.046	-0.222	-0.270
	(2.83)**	(2.61)**	(0.20)	(0.31)
round1	-0.871	-0.888	-0.865	-0.886
	(9.18)**	(9.37)**	(9.14)**	(9.99)**
round2	-0.847	-0.865	-0.842	-0.865
	(8.91)**	(9.11)**	(8.88)**	(9.74)**
round3	-1.006	-1.010	-0.986	-1.001
	(11.50)**	(11.56)**	(11.28)**	(12.39)**
round4	-0.786	-0.793	-0.771	-0.784
	(8.65)**	(8.75)**	(8.54)**	(9.58)**
Micro		0.739	0.727	0.701
		(2.46)*	(2.40)*	(2.59)**
Small		-0.257	-0.291	-0.311
		(2.05)*	(2.33)*	(2.52)*
Medium		-0.260	-0.263	-0.272
		(3.05)**	(3.09)**	(3.19)**
Exports			0.000	0.000
			(2.56)*	(4.77)**
Constant	8.026	8.439	8.515	8.648
	(48.31)**	(31.87)**	(32.14)**	(34.28)**
Observations	1942	1942	1942	1942
R-squared	0.63	0.63	0.64	
Number of firm		535		
Robust t-statistics in parentheses				

Note: * significant at 5%; ** significant at 1%.

Competition is measured using the Hirschman-Herfindahl Index (HH). The paper argued that in principal, there are three ways through which competition has proven to influence productivity; first within firm effect whereby firm specific aspects that influences productivity might be determined by trends in competition. The second most important vehicle that competition can influence productivity is via stimulating innovation. The study major findings indicate a positive correlation between competition and productivity. In particular it is indicated that 1 percent increase in competition results into 0.4 percent increase in productivity. But when the panel estimates are introduced the correlation between competition and productivity disappear. In particular, the fixed effects estimates and GMM estimates show that competition has no productivity effect among the manufacturing firms. The results suggest that OLS estimates reported in columns [1-2] are biased. In fact the firm specific characteristics or attributes have a lot to influence the observed competition effect. There is no causal relationship

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There is a question on what determines the competition at firm level. The results confirm that competition measured using market share HH index is influenced by the output per employee, exports intensity in input usage and firm size. However, when the estimates control for firm fixed effects it is only export that appears to have a strong positive correlation with competition. The implication of the results is that our estimates strongly support the hypothesis of export led growth as a way forward to strengthen performance of manufacturing sector of Tanzania. The anticipation of the analysis is that if competition has been positive to influence firm behavior such as investing in more efficient production then profit must be positively correlated with competition. The OLS results show a positive correlation between profit and competition in Tanzania manufacturing firms. The results are strongly significant suggesting that 1 percent increase in competitiveness measured by market share of firm results into more than 1 percent increase in profit. But when firm specific characteristics are controlled for, the results suggest no correlation between profit and competition. We discuss such findings that our OLS results are biased such that they pick positive correlation between omitted firm specific aspects with competition and ultimately profit. While in reality there are firm specific characteristics that are correlated with firm market share which also influence profit. It could for instance be the fact that companies that are well connected to reliable markets will sell more and also will be more profitable.

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