# THE PROCEEDINGS OF 5th INTERNATIONAL STRATEGIC MANAGEMENT CONFERENCE

*Striking the Right Balance Between Existing Strategy and New Opportunities with Special Emphasis on Turbulent Markets*

***July 2-4, 2009***

**Stellenbosch, South Africa**

# 5th. INTERNATIONAL STRATEGIC MANAGEMENT CONFERENCE

***"Striking the Right Balance Between Existing Strategy and New Opportunities with Special Emphasis on Turbulent Markets"***

*July 2-4, 2009*
*Stellenbosch, South Africa*

**Honorary Presidents**
Ali AKDEMİR (Ph.D.)
Cuma BAYAT (Ph.D.)
Alinur BÜYÜKAKSOY (Ph.D.)
Russel BOTMAN (Ph.D.)

**Chairman**
Erol EREN (Ph.D.)

**Co-Chair**
Oya ERDİL (Ph.D.)
Ali AKDEMİR (Ph.D.)
Johan HOUGH (Ph.D.)

**Typesetting**
Mehtap ÖZŞAHİN

**ISBN**
978-605-60771-0-4

**Organizing Institutions**
Beykent University

Gebze Institute of Technology

Canakkale Onsekiz Mart University

Stellenbosch University



Print: Pozitif Printinghouse / Ankara / Turkey - e-mail: pozitif@pozitifmatbaa.com

# TABLE OF CONTENTS

## CRISIS MANAGEMENT & GOVERNANCE



## STRATEGIC LEADERSHIP & STRATEGIC ALLIANCES - AMBIDEXTERITY

## *RESOURCE BASED VIEW & CULTURE - STRATEGY*



## *TOTAL QUALITY MANAGEMENT & SERVICE QUALITY MANAGEMENT*

## *STRATEGIC MARKETING*

## *INTERNATIONAL INTEGRATION & FOREIGN DIRECT INVESTMENT*



## *STRATEGIC HUMAN RESOURCE MANAGEMENT & ORGANIZATIONAL BEHAVIOR*

## *SUPPLY CHAIN MANAGEMENT & INNOVATION MANAGEMENT*



## *STRATEGIC INTENTIONS –ORIENTATIONS & STRATEGIC DECISION MAKING*



## *FINANCE, ENTREPRENEURSHIP & SMES*

## *ORGANIZING COMMITTEE*

- *Erol Eren (Chairman, Beykent University, Istanbul-Turkey)*
- *Oya Erdil (Co-Chair, Gebze Institute of Technology, Kocaeli-Turkey)*
- *Ali Akdemir (Canakkale Onsekiz Mart University, Canakkale-Turkey)*
- *Johan Hough (Stellenbosch University, Stellenbosch - South Africa)*
- *Lütfihak Alpkan (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Cemal Zehir (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Ali E. Akgün (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Halit Keskin (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Tanses Gülsoy (Beykent University, Istanbul-Turkey)*
- *Güngör Tuncer (Beykent University, Istanbul-Turkey)*
- *Fuat Oktay (Beykent University, Istanbul-Turkey)*
- *Gülruh Gürbüz (Marmara University, Istanbul-Turkey)*
- *Irem Erdoğmuş (Marmara University, Istanbul-Turkey)*
- *Esin Sadıkoğlu (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Mehtap Özşahin (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Meral Elçi (Gebze Institute of Technology, Kocaeli-Turkey)*

## *ADVISORY BOARD & REVIEW COMMITTTEE*

- *A. Asuman Akdoğan (Erciyes University, Kayseri-Turkey)*
- *Abdurrahman Benli (Canakkale Onsekiz Mart University, Canakkale-Turkey)*
- *Adem Öğüt (Selçuk University, Konya - Turkey)*
- *Adnan Çelik (Sütçü İmam University, Kahramanmaraş-Turkey)*
- *Adnan Ceylan (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Ahmet Kesik, Ph.D., Associate Professor (President of Strategy Development Unit, Ministry of Finance, Republic of Turkey)*
- *Alain Crochet (University of Sorbonne Nouvelle - Paris 3, France)*
- *Alexander Egorshin (The Nizhny Novgorod Institute of Management and Business, Russia)*
- *Ali Akdemir (Canakkale Onsekiz Mart University, Canakkale-Turkey)*
- *Ali Ekber Akgün (Gebze Institute of Technology, Kocaeli-Turkey)*
- *Ali Halıcı (Baskent University, Ankara-Turkey)*
- *Alistair M Brown (Curtin University of Technology, Western Australia)*
- *Amar KJN Nayak (Xavier Institute of Management, Orrissa-India)*
- *Andrei Burenin (Irkutsk State University, Russia)*
- *Andrey Dashkov (Moscow State University, Russia)*
- *Asım Şen (St. John Fisher College, USA)*
- *Atilla Dicle (Yeditepe University, İstanbul-Turkey)*

# *FOREWORD*

***Dear Participants and Colleagues;***

*Welcome to the International Strategic Management Conference that we hold for the fifth time this year in Stellenbosch City of South Africa. We greet you all with respect and love on behalf of organization committee arranging the conference.*

*We have organized this conference with the academic cooperation of Beykent University, Gebze High Technology Institute and Çanakkale 18 Mart University again as always. This year; Stallenbosch University of South Africa as the host university as well as the Ministry Finance, Strategy Development Department from Turkey have also attended to this organization and supported us. I would like to thank to those who have had contribution in current attainment of the conference in a successful manner. Especially we would like to express our sincere and distinctive thanks to Prof. Johan HOUGH, our host doing his utmost for organizing the fifth conference in nice university town of this beautiful country at the far end of the world.*

*123 individuals from 15 different countries of the world are attending 2009 conference with 83 reports. Reports have been generally written by scientists from Europe, Balkan states, Russia, Middle East, Africa, Australia and USA. The countries providing reports are as follows in alphabetical order; Albania, Australia, Bosnia-Herzegovina, Canada, France, Hungary, Iran, Lithuania, Russia, Kuwait, Pakistan, South Africa, Turkey, United Kingdom and USA.*

*There has been an enormous increase in the number of those who have provided report for but not be able to attend the meeting due to the long distance of the conference place, outbreak of communicable influenza as well as our guests suffering from travel-sickness. For this reason we have reduced the period of the conference, which have been originally planned to last two and a half days, to two days. Therefore, a reasonable time has been provided to some of our guests for traveling around Stellenbosch and Cape Town cities.*

*After a while 3 dear expert scientists will argue about effects of global crisis on management strategies, one of the actual problems of world as the keynoters in our opening. Thereby we will also have the possibility to handle an actual problem in terms of Strategic Management at all hands.*

*Dear participants, ladies and gentlemen, while I welcome you again wish for our 5th year conference to be accomplished and express best regards.*

*Erol EREN (Ph.D)*
*Conference Chairman*
*Beykent University*

## *FOREWORD*

*We are pleased to welcome you to the 5th International Strategic Management Conference in Stellenbosch, South Africa. This year, the theme is "Striking the Right Balance between Existing Strategy and New Opportunities with Special Emphasis on Turbulent Markets".*

*Participants coming from different parts of the world aim to discuss and explore for strategic management issues and approaches to managing global crises. We are going to debate on different topics including industry analysis, innovation, entrepreneurship, marketing and financial aspects of strategies addressing mainly problems and issues in turbulent environments.*

*Academicians from different countries submitted original papers for conference presentation and for publication in this Proceedings Book. All competitive papers have been subject to a peer review. The results of the evaluation efforts produced 83 empirical, conceptual and methodological papers involving all functional areas of strategic management of strategic management with a specific focus on strategic opportunities in turbulent markets. I would like to express our appreciation to the reviewers for reviewing the papers that were submitted to this conference. We also thank to all those who submitted their work to be considered for presentation in the conference.*

*I would like to thank to the Rectors of Universities for their continuing cooperation. My special thanks go to Alinur Büyükaksoy, Rector of Gebze Institute of Technology for his valuable support and encouragement.*

*Many people worked very hard for the realization of this organization. The Conference could not have been held without the diligent work of Professor Erol Eren, Faculty Dean and Chairman of the Conference. He made great effort to organize and perfect all arrangements. Special thanks to him for his leadership and execution of 2009 Conference. I want to extend special appreciation to Mehtap Özşahin for her hard work and commitment to the Conference development. She carefully worked in coordination with us during the all phases of the organization. And finally thanks to Professor Johan Hough from Stellenbosch University for his efforts and cooperation.*

*We hope that you all will enjoy and benefit from the conference and enjoy your stay in this great and magnificent land, Stellenbosch.*

*Oya ERDIL, (Ph.D.)*
*Co-Chair of the Conference*
*Gebze Institute of Technology*

## *FOREWORD*

*Dear Guests, Dear Colleagues and Delegates from all over the world,*

*I would like to welcome you (on behalf of Stellenbosch University) with open arms to our African continent and specifically to this prestigious international event. This fifth annual Strategy conference, which has been made possible by the joint efforts of four leading international recognized universities, has become a major event on the Global Academic Strategy calendar. I think a short introduction to our university will be interesting.*

*Stellenbosch University is recognized as one of the four top research universities in South Africa. It takes pride in the fact that it has one of the country's highest proportions of postgraduate students of which almost ten percent are international students. Our University lies in the picturesque Jonkershoek Valley in the heart of the Western Cape Winelands. The earliest roots of the University can be traced back to the 17th century when a beginning was made with regular school instruction. In 1859 the Theological Seminary was founded and in 1866 the Stellenbosch Gymnasium. In 1881, the "Arts Department" of the Stellenbosch Gymnasium became the Stellenbosch College and renamed the Victoria College in 1887. In 1918, Victoria College made way for an independent university and Stellenbosch University opened its doors for some 500 students and 39 lecturers. The University has since then grown into the internationally recognized institution of excellence it is today with more than 25 000 students, 800 lecturers and some 50 research and service bodies.*

*I want to thank all the people of the Turkish Universities who have collaborated with us for the preparation of this conference on strategic management and sustainable strategies in turbulent and recessionary environments. A word of thanks to Jo Venter and her team from STIAS for preparing this excellent facility for our delegates, everybody at the registration desk and the organizing committee for their efforts. Finally, we acknowledge our sponsors, McGraw-Hill South Africa and Distell Wines for their contributions to make this conference unforgettable! We wish that all the valuable work presented in this conference adds value to the international academic experience but also to improving the lives of ordinary citizens in our global village.*

*Johan HOUGH (Ph.D.)*
*Co-Chairman of the Conference*
*Stellenbosch University, South Africa*

## *FOREWORD*

*We are so pleased to have realized the fifth of the Strategic Management Conference series, which has become, I am glad to say, a traditional forum at an international level for theoreticians and practitioners of Strategic Management. It gives me immense pleasure and pride to be a part of this.*

*When we first started this conference with Prof. Dr. Erol Eren of Beykent University five years ago, this academic event had a narrower scope and did draw attention mostly from within Turkey. But now, we are most happy to see that this conference series can be materialized beyond the borders of Turkey with our new international partners. Stellenbosch University of South Africa, a truly beautiful country which will be the host of Football World Cup Finals of 2010, kindly hosted us, and we do cherish this partnership wholeheartedly.*

*Strategic Management requires long-term thinking and planning. It is already established that not only commercial companies need and do Strategic planning, but also governments, including its various institutions and sub-branches, universities and even individuals, be it private entrepreneurs or academics who carry out researches on certain subjects, feel the need to draw a road map for their respective careers in the future. In this respect, Strategic Management is designed not only for five or ten years, but for fifty or one-hundred years if necessary. These qualities of Strategic Management impelled us to organize this conference series so that theoreticians and practitioners of this subject can get together and share their findings and ideas with one another. We also hope that the proceedings of the conference will contribute to the field academically and can be a reference book for all interested in the Strategic Management.*

*Many people contributed to this conference and I am truly thankful to them for their enduring support and effort. Among these, though, some of them deserve particular mention. Prof. Dr. Erol Eren, one of the most distinguished academics in the field of Strategic Management and a close colleague of mine, did his utmost to make this conference a success, and we all should be grateful to him for what he has done for this conference series.*

*Prof.Dr. Cuma Bayat, the Rector of Beykent University, and Prof. Dr. Alinur Büyükaksoy, the Rector of Gebze Institute of Technology, our longtime partners in this conference, again provided invaluable contribution to the conference, and I would like to thank them for that. I would like to express my gratitude to our new international partner, Prof. H. Russel Botman, the Rector and Vice-Chancellor of the Stellenbosch University, for gracefully hosting us. Assoc. Prof. Dr. Ahmet Kesik, the Head of the Strategy Development Office of the Turkish Public Finance Ministry, has been a continuing supporter of our conference and various other academic activities of our university. Dr. Kesik deserves all praise for his endeavors.*

*Last but not least, I would like to thank Mehtap Ozsahin and Erdal Aydin, two very diligent workers of our conference, for their relentless effort and impeccable work ethic to make this conference possible.*

*Ali Akdemir (Ph.D.)*
*Co-Chair of the Conference &*
*Rector of the Çanakkale Onsekiz Mart University*

## *FOREWORD*

*Since its establishment in 1992 Gebze Institute of Technology (GIT) has concentrated on high quality research in science, engineering and business management. A strong commitment to the continuing expansion of research, inventions and publications is an important feature of our vision and strategy. In the light of our research and science orientation we, as GIT, get involved in conference and colloquial activities in order to increase information sharing among institutions and academicians. This year, we provide our support for the success of the 5th International Strategic Management Conference which is held in Stellenbosch.*

*On behalf of my university and staff members I would like to welcome the delegates of the 5th International Strategic Management Conference with the theme 'Striking the right balance between existing strategy and new opportunities, with special emphasis on turbulent markets' organized by Beykent University, Gebze Institute of Technology, Çanakkale Onsekiz Mart University and with the kind cooperation of the Stellenbosch University of Stellenbosch, South Africa.*

*I sincerely would like to thank to Cuma Bayat, Rector of Beykent University, Ali Akdemir, Rector of Çanakkale 18 Mart University, who give the excellent example of cooperation to realize this annual international conference in a continuing manner.*

*My special thanks go to the Chairman Professor Erol Eren for his success and hard work for the organization and realization of the conference. I would like to thank to colleagues and staff of our Faculty of Business Administration for their hard work, sacrifice and talent. I also thank to Johan Hough and the staff of Stellenbosch University for their efforts and cooperation.*

*Finally, I wish that this conference will contribute to the world of scientific community.*

*Alinur BÜYÜKAKSOY (Ph.D)*
*Rector-Gebze Institute of Technology*

# *FOREWORD*

***Dear Participants;***

*This year, we have held the International Strategic Management Conference being organized on annual basis traditionally with academic cooperation of universities from different countries of the world in South Africa under hosting of Stellenbosch University. I welcome all our guests as myself and as the chancellor of Beykent University with greeting you respectfully.*

*Beykent University is a foundation university established in 1997. It provides associate, undergraduate, postgraduate and doctorate studies through six faculties, two colleges, a vocational school, two institutes and two research centers included in its organization. Our university has 10000 students approximately and provides service with 4 campuses located in different districts of Istanbul.*

*Beykent University maintains its student and academic member exchange programs in Turkey with different universities within the Farabi program frame and apart from Turkey with USA universities and particularly Erasmus Program with European countries. Thus, it has achieved the status of a ''World University''.*

*We are experiencing a fair example of international cooperation with other universities in Strategic Management Conference. Such international collaborations encourage not only universities from all four corners of the world but also researcher academicians for association and interoperability studies. For this reason, I congratulate members of organizing committee throwing the academicians of 15 different countries together.*

*We, as Beykent University, give great importance to all research and publication studies and act as sponsor for them. Therefore, we attend national and international scientific organizations as a partner by continuing the academic cooperation with institutions supporting morally and materially this research and publication studies as we do. We are in opinion that international conferences can be long-lasting and effective only by the association of different universities.*

*I would like to express my thanks to all members of organizing committee notably chairman Prof. Dr. Erol EREN holding this conference for 5 years accomplishedly, arbitrators who contributed evaluating the papers and especially Prof. Dr. Johan HOUGH doing the honors for fifth conference.*

*Cuma BAYAT (Ph.D.)*
*Rector-Beykent University*

# *FOREWORD*

***Dear Conference Delegates**,*

*It gives me immense pleasure to welcome you to this very important conference on South African soil – moreover because of the timing and value of this conference in one of the most challenging times in the global economy. We are all aware of the turbulence, the international repercussions and the demoralizing impact it has had on people throughout the western world. I trust that the leading edge thinking flowing from this event will enrich global thinking on how to bring hope to entrepreneurs and ordinary citizens alike in otherwise depressing circumstances.*

*I trust that a conference such as this, flowing from the strategic partnership between our respective Universities, will play an important part in our endeavor to put science behind some of the most pressing needs of our country and the African continent at large. We have embarked on a program of research and knowledge pioneering that we popularly refer to as "science for society". In this regard our research programs are honed on issues such as alleviating pandemic poverty, the promotion of food security, the promotion of democracy and ensuring sustainable utilization and development of the environment.*

*These broad trans-disciplinary research areas will lay the foundation for our pedagogy of hope that will be the future hallmark of this university. Incidentally, these crucial themes are strong features of the Millennium Development goals of the United Nations and in this regard Stellenbosch University is positioning itself at the heart of the international development agenda.*

*I wish you well in your deliberations and I am sure that the ideas and suggestions that will be presented at this conference will form the foundation for a mutually beneficial relationship between our respective institutions -- and that it naturally will deliver on the needs and challenges of a new economy where we can strike the right balance between existing strategy and new opportunities.*

*H Russel BOTMAN (Ph.D.)*
*Rector and Vice-Chancellor*
*Stellenbosch University*

## *FOREWORD*

*Rapid changes in the information and communication technologies, globalization, and sharp population increase and increasing needs make the restructuring in the public management compulsory because these changes require public administrations to provide faster and higher quality services and meanwhile to use their resources more efficiently. This urged the public administrations to make long-term plans and to prepare their own road maps in line with the priorities they determined.*

*In this framework strategic management allows the public administrations to think from a long term perspective and increases efficiency of the public administrations in terms of developing policies and enhancing their administrative capacity. Strategic management refers to the path between the current situation of the institution and the desired situation in a way to include strategic planning, implementation and control processes; and it integrates all other management processes in order to provide a systematic, proper and effective approach to set, discover, audit and update strategic objectives of the institution.*

*In order to ensure success of the strategic management and to obtain the expected contributions and results, practices within the scope of the strategic management should be monitored and reported at certain intervals; an evaluation mechanism for detection and correction of the failing aspects should be put into effect as well as the top management should believe in the importance and benefit of the strategic thinking and strategic planning.*

*Due to the rapid changes in the world, it is not enough now to find momentary and temporary solutions for both financial and administrative problems of the public management and also problems in provision of the public services.*

*In this scope in order to take permanent and institutionalized measures against the problems encountered in the public management and to provide more flexible, faster and higher quality public services, focus of the restructuring in the public management should be the strategic management approach.*

*I hope that during the annually organized International Strategic Management Conference, presentations and speeches by the distinguished participants will make considerable contributions to the strategic management literature.*

*Ahmet KESİK, (Ph.D.)*
*Head, Strategy Development Unit*
*Ministry of Finance*

# *CRISIS MANAGEMENT & GOVERNANCE*

# THE CHANGING'S OF SHARE PRICE IN THE FINANCIAL CRISIS: A COMPARATIVE STUDY FOR AUTO MAKERS

**Erol Eren**
**Serdar Alnıpak**
**Metin Uyar**

**Beykent University, Turkey**

## ABSTRACT

The current crisis in the global markets, which originated in the US subprime mortgage segment and quickly spread into other market segments and countries, is already seen today as one of the biggest economics crisis in history. The occurrence of market crash or financial crisis is possible key factor of share price inefficiency. This paper empirically investigates the effects of the current financial crisis on the efficiency of the leader auto makers' share price. The share price, applying the univariate test statistics for the two sub-periods of crisis. The article proceeds in the following manner. Firstly, the study will explain main reasons of global financial crises. Secondly the study will analyze all share price changing's of 10 leader automotive companies. Finally, crisis strategies will be discussed for adjustment of related ratios of leader auto makers. The automotive industry is selected, because the share of automotive industry is approximately 30% in the global trade and their income decreased 36% in the quarter one of 2009, so that share price is very important for all strategic decision, especially motor industry.

**Key Words:** Financial Crises, Share Price, Struggle Strategies

## 1. INTRODUCTION

As we all know by now, the global financial crisis has seriously affected the automotive industry worldwide. Manufactures (GM, Ford, Toyota etc.) have reported a downturn in sales and productions as well as their income. The automotive industry crisis of 2008–2009 is a global financial crisis in the auto industry that began during the latter half of 2008. The crisis is primarily felt in the United States' automobile manufacturing industry and, by extension, Canada, due to the Automotive Products Trade Agreement, but other automobile manufacturers, particularly those in Europe and Japan, are also suffering from the crisis. The automotive sector was first weakened by the substantially more expensive automobile fuels linked to the 2003-2008 oil crisis which, in particular, caused customers to turn away from large sport utility vehicles and pickup trucks, the main market of the American "Big Three" (General Motors, Ford, and Chrysler). The US automakers also suffered from considerably higher wages than their non-unionized counterparts, including salaries, benefits, healthcare, and pensions. In return for labor peace, management granted concessions to its unions that resulted in uncompetitive cost structures and significant legacy costs.

In 2008, the situation became critical because the global financial crisis and the related credit crunch placed pressure on the prices of raw materials. In certain countries, particularly the United States and West European countries have been under heavy criticism since their vehicle offerings were largely fuel inefficient SUVs and light trucks, despite the increase in the price of oil. Accordingly, they suffered both from consumer perception of relatively higher quality models available from abroad — particularly from Japan, Korean and Chinese manufactures.

As of the beginning of 2009, the vehicle companies of the world are being hit hard by the economic slowdown across national boundaries. Car companies from Asia, Europe, North America, and elsewhere have been forced to implement creative marketing strategies to entice reluctant consumers to purchase vehicles, when many firms are experiencing double digit percentage sales declines. Major manufacturers, including the Big Three and Toyota are offering substantial discounts (http://www.toyota.co.jp/en/ir/index.html 20.01.2009). Hyundai is even offering to allow customers to return their new cars if they lose their jobs (http://worldwide.hyundai.com/ 20.01.2009).

The occurrence of market crash or financial crisis is possible key factor of share and other financial ratios inefficiency. Firstly, the paper explains causes of crises (subprime crisis). Secondly, we discuss to effects of the current financial crisis on the efficiency of the leader auto makers' share price. Finally, crisis strategies will be discussed for adjustment of leader auto makers.

The effects of financial crises had argued various scholar studies, financial crises have alternatively been attributed to monetary policy (e.g., Aghion et al., 2001), coordination problems among investors (e.g., Chang and Velasco, 1999), the activity of large traders and speculators (e.g., Brown et al., 2000; Kaminsky et al., 2003, 2004; Kyle and Xiong, 2001; Kim and Wei, 2002; Kodres and Pritsker, 2002; Corsetti et al., 2004), herding (e.g., Chari and Kehoe, 2004), the interaction of stock and foreign exchange markets (Corsetti et al., 1999).

## 1.1 Background of The Crisis

The ongoing crisis in the global financial markets, which originated in the US subprime mortgage segment and quickly spread into other market segments and countries, is already seen today as one of the biggest economical crises in history. The current market turbulence, it is useful to recall, was preceded by a period of unusually benign macroeconomic conditions marked by strong growth and low inflation. This translated in equally benign conditions for the global banking system, with low default rates, high profitability, strong capital ratios, rapid growth in business volumes and strong innovations. While these factors combined meant that the global banking system had entered the crisis in a position of unusual strength, the favorable environment may also have contributed to the crisis in that it led to overconfidence and dulled the risk consciousness on the part of at least some actors Ackermann (2008:330).

Underlying the subprime crisis were essentially two interrelated factors: on the one hand, the boom in US real estate markets, and on the other hand, the high liquidity in the global financial markets. The latter was, in turn, fuelled by the significant easing of US monetary policy over an extended period of time and by the additional boost to global liquidity as many emerging markets had tied their exchange rates to the US dollar and therefore had to match the expansive US monetary policy.

### 1.1.1 The Real Estate' Price

The price increases in the US real estate markets were partly justified given the demographic developments in the US. But they were certainly fuelled by the accommodative monetary policy environment. At the same time, the boom in the US housing markets would not have been possible had it not been facilitated by innovations in mortgage financing. One of these innovations was the emergence of the subprime mortgage segment, whose share in total new business rose from 6% in 2001 to 15% in 2006. These products allowed borrowers with impaired credit histories and low incomes to buy property, too. Towards the end of the lending boom, however, credit standards deteriorated further with the emergence of teaser rates, "stated income" loans (low documentation loans where mortgage brokers and borrowers simply stated the borrower's income) as well as "ninja" loans (for borrowers with "no income, no job and no assets").

### 1.1.2 Excess Liquidity

For the fundamentals underlying the global subprime crisis, we need look little further than the unprecedented actions of Alan Greenspan, Chair of the Federal Reserve, in lowering the Federal Funds Rate (FFR) from 6.54% in July 2000 to 1.1% by July 2003. This was one of the most dramatic policy interventions up until that time. Greenspan injected huge amounts of liquidity into the US economy and lowered interest rates due to fears of recession stemming from the hi-tech meltdown commencing in 2000 and the 9/11, 2001, assault on the United States. Three years later, in July 2006, the rate was back at 5.24%. The "irrational exuberance" he gave a name to, exemplified his period in office setting monetary policy. Moreover, much of this exuberance seems to have been inspired by the very extreme nature of the policy interventions that he initiated.

## 2. The Effects of Crisis on Automotive Manufactures

The automotive industry crisis of 2008–2009 is a global financial crisis in the auto industry that began during the latter half of 2008. Most agree that the crisis has occurred mainly as a result of the poor business practices of the Big Three U.S. automakers, since Asian companies that manufacture automobiles in the U.S. are not experiencing similar problems. A December 22, 2008 New York Times article stated (http://www.nytimes.com/pages/business/index.html 22.12.2008), "For the most part, the so-called auto transplants — foreign-owned car companies with major operations in the United States — have deep pockets and ample credit, and they are not facing potential bankruptcy like General Motors and Chrysler." With high oil prices and a declining US economy due to the subprime mortgage crisis, the Big Three are rethinking their strategy, idling or converting light truck plants to make small cars. Due to the declining residual value of their vehicles, Chrysler and GM have stopped offering leases on the majority of their vehicles (http://www.gm.com/corporate/investor_information/cal_events/index.jsp 25.03.2009). The annual capacity of the industry is 17 million cars; sales in 2008 dropped to an annual rate of only 10 million vehicles made in the U.S. and Canada. The crisis has affected auto companies around the world, with large sales decreases experienced by all.

In China, the government reduced taxes related to automobile purchases in order to spur flagging sales in 2008. In January 2009, Chinese auto-manufacturer Cherry (http://www.cheryinternational.com/news 22.03.2005) reported unprecedented monthly sales. In Japan, The Toyota Prius is one of Toyota's Hybrid Fuel efficient vehicles which are in short supply With high gas prices and a weak US economy in the summer of 2008, Toyota reported a double-digit decline in sales for the month of June, similar to figures reported by the Detroit Big Three (http://www.toyota.co.jp/en/ir/financial_results/2009/semi/summary.pdf 25.12.2008). For Toyota, these were attributed mainly to slow sales of its Tundra pickup, as well as shortages of its fuel-efficient vehicles such as the Prius, Corolla and Yaris. In response, the company has announced plans to idle its truck plants, while shifting production at other facilities to manufacture in-demand vehicles. On December 22, 2008, Toyota declared that it expected the first time loss in 70 years in its core vehicle-making business. Loss of $1.7 billion, in its group operating revenue, would be its first operating loss since 1938 (Company was founded in 1937). Toyota saw its sales drop 33.9 percent and Honda Motor by 31.6 percent. On 5 December 2008 Honda Motor Company announced that it would be exiting Formula One race with immediate effect due to the 2008 economic crisis and are looking to sell the team. Honda has predicted that there may be reductions among part-time and contract staff (http://world.honda.com/news/2009/c090306Honda-Racing-F1-Team/ 06.03.2009). Upper management bonuses would also be reassessed and directors in the company will take a 10 percent pay cut effective January 2009. Nissan, another leading Japanese car manufacturer, announced that it also would be slashing production and will reduce its output by 80,000 vehicles in the first few months of 2009 (http://www.nissan-global.com/EN/DOCUMENT/PDF/FINANCIAL/TSE/2008/20083rd_tsefiling_243_e.pdf 28.03.2009).

Toyota recently announced on Dec 22, 2008, it expects to barely break even this year and slashes profit forecasts amid sales slump (http://www.toyota.co.jp/en/ir/financial_results/2009/semi/summary.pdf 25.12.2008). The Japanese automaker, often held up with Honda as a success story for the rest of the auto industry to follow, said it expects a slim profit margin of US$555 million for the year ending in March 2009. Toyota had originally been projecting a massive profit of $13.9 billion for that period. Their sales in the United States were down 34 per cent last month and were down 34 per cent in Europe as well. They are expecting a loss which would be the equivalent of about $2 billion . Facing its first loss in nearly sixty years, Toyota is seeking loans from the Japanese government.

South Korean automakers have been generally much more profitable than their US and Japanese counterparts, recording strong growth even in depressed markets such as the United States. Despite a global economic slowdown, Hyundai-Kia successfully managed to overtake Honda Motor in Summer 2008 as the world's 5th largest automaker, climbing eight rankings in less than a decade. Nonetheless, South Korean automakers were not immune to this automotive crisis and in December 2008 Hyundai Motor Company had begun reducing production at plants in the U.S., China, Slovakia, India and Turkey because of sluggish demand (http://worldwide.hyundai.com/ 20.03.2009). The company missed an earlier projection of 4.8 million units for 2008 and announced a freeze of wages for administrative workers and shortened factory operations as demand weakens amid a global financial crisis.

In Europe where car sales had also drastically decreased, consideration was being given to financial support for the automotive industry, particularly in France, Germany and Italy. On November 20, 2008, French automobile manufacturer PSA Peugeot Citroen predicted sales volumes would fall by at least 10% in 2009, following a 17% drop in the current quarter. As a result, it planned to cut 2,700 jobs. On the 11 February 2009, PSA announced it would cut 11,000 jobs world wide, however none of these are expected to be in France (http://www.psa-peugeot-citroen.com/en/news/ 20.02.2009). Renault announced a net profit for 2008 of 599 million Euros for the 2008 financial year. This was a 78% drop in profits from the 2007 financial year. European sales fell 4% and world wide sales 7%, forcing Renault to abandon their 2009 growth targets (http://www.renault.com/en/Lists/ArchivesDocuments/Renault%20-%202008%20Interactive%20Annual%20Report.pdf 25.03.2009). This however made Renault one of the few car makers to return a profit. Renault consistently struggled to return profits in the 1990s.

Fiat in Italy announced that it will extend its temporary plant closures in Italy by a month; the Pomigliano d'Arco, the main plant for its Alfa Romeo cars will be shut for four weeks. However, on February 20, 2009, reacting to actions by the Italian government to stimulate the automotive sector, Fiat said its plant closures would be curtailed. The company also forecast that sales in Europe will drop by 14 percent in 2009 (http://www.fiatgroup.com/en-us/shai/banns/3/pages/default.aspx 25.03.2009).

## 2.1 Changing's of Share Price of Automotive Companies

In this section, changing's of share prices are discussed for sub-two period that pre-crisis and during crisis. For this aim, employed daily data NYSE, Tokyo Nikei with other global stock market indicates and global web sites of automotive manufacturers especially investor relations tabs covering the period January 1, 2006 –March 31, 2009. All data had used in univariate statistics analysis. There is a main hypothesis in article. Testing for hypothesis used to Paired-Samples T test.

H1: There is very important difference in share price of automotive companies for pre-crisis and crisis timing.

## 2.2 Data and Analyze

All data gathered web sites of auto manufacturers' investor relations tab that shows share price and other financial indicators. A Table 1 shows changing's of share prices of leader's auto makers for two sub periods. While the most change share is GM (-92%), least change share of Toyota (-26%) for 1 Jan. 2006-1 Apr. 2009. Average change is approximately -17%. Americans auto maker' share price decreased than European and other regions manufactures' share price. Same information being given Figure 1.

**Table 1 Changing's Share Price (%)**

| | 1 Jan. 06-1 Jan. 08 | 1 Jan. 06- 1 Apr. 09 | 1 Jan. 07- 1 Apr. 09 | 1 Jan. 08- 1 Apr. 09 | 1 Jan. 08- 1 Jan. 09 | 1 Jul. 08- 1 Apr. 09 | 1 Jan. 09-1 April 09 |
|---|---|---|---|---|---|---|---|
| GM | 17 | -92 | -94 | -93 | -89 | -82 | -36 |
| Ford | -23 | -80 | -79 | -74 | -72 | -64 | -7 |
| Toyota | 4 | -26 | -42 | -29 | -41 | -11 | 20 |
| Honda | 12 | -28 | -28 | -11 | -28 | -12 | 24 |
| Renault | -2 | -72 | -77 | -71 | -80 | -60 | 43 |
| Fiat | 77 | -58 | -78 | -76 | -75 | -68 | -3 |
| VW | 210 | 385 | 177 | 56 | 65 | 16 | -5 |
| Hyundai | -44 | -88 | -82 | -78 | -70 | -71 | -27 |
| Nissan | -32 | -79 | -80 | -69 | -63 | -61 | -16 |
| PSA | 3 | -63 | -64 | -64 | -73 | -44 | 34 |
| Average Share Price | 22 | -17 | -45 | -51 | -53 | -46 | 2 |

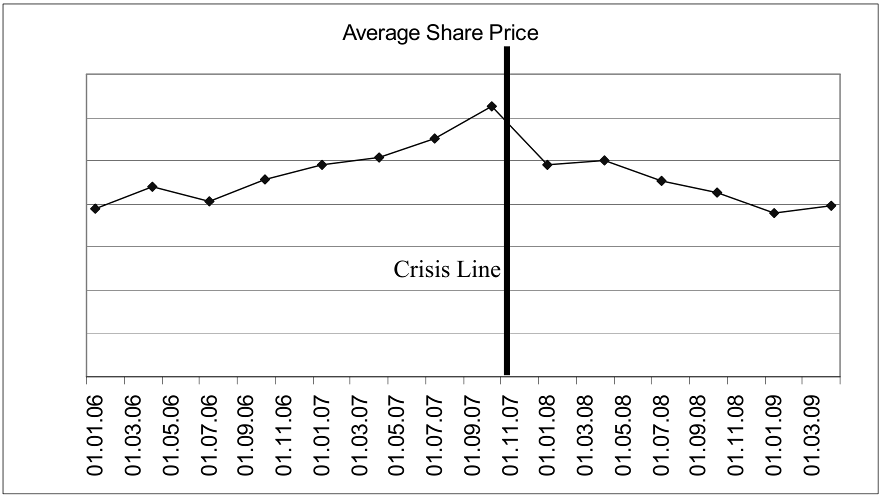



**Figure 1. Average Share Price of Automotive Industry**

Testing for hypothesis used to Paired-Samples T test. This test utilize to compare two differ time. For example pre crisis and after crisis.While the first period (pre-crisis) is come into existence 01.01.2006-01.07.07 for 7 quarter, second period (crisis timing) is consist of 01.07.07-01.04.09 for 7 quarter. The Table 2 reflects results of paired samples test for leader auto makers.

**Table 2. Analyze Results**

| Paired Samples Test | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Paired Differences | | | | | | | |
| | | | | | 95% Confidence Interval of the Difference | | | | |
| | | Mean | Std. Deviation | Std. Error Mean | Lower | Upper | t | df | Sig. (2-tailed) |
| Pair 1 | PreCrisis - CrisisTiming | -4,06429 | 14,94837 | 5,64995 | -17,88922 | 9,76065 | -5,719 | 6 | ,009 |

According to T test, there is very important difference for two sub periods. The Sig (signifance) level is small than 0,005, so that H1 accepted. Now therefore share prices of leaders automakers are affected by financial crisis. Especially, financial crisis had effected automotive industry after July 2008 (-%46).

# CONCLUSION

The automotive industry designs, develops, manufactures, markets, and sells the world's motor vehicles. In 2007 and 2008, more than 140 million motor vehicles, including cars and commercial vehicles were produced and sold worldwide. But, as of the beginning of 2008, the vehicle companies of the world are being hit hard by the economic slowdown across national boundaries. Car companies from Asia, Europe, North America, and elsewhere have been forced to implement creative marketing strategies to entice reluctant consumers to purchase vehicles, when many firms are experiencing double digit percentage sales declines. A. The industry has already reacted swiftly and responsibly within the boundaries of existing instruments and economic viability and continues to do so:

1. **Production Strategy :** Manufacturers have and are adapting their output to the anticipated significant decrease in demand for vehicles

2. **Employment Strategy:** Manufacturers are readjusting their employment base in an as socially responsible way as possible, using the flexibility agreements at their disposal (extended vacations, taking weeks out of production, shortening working weeks, non-renewal of short-term contracts and non-filling in of vacancies), and in close contact with unions and governments

3. **Cost Strategy:** Manufacturers are cutting all discretionary costs by limiting travel and meetings, downsizing advertising and sponsorships, by in sourcing activities, and much more

4. **Investments & R&D Strategy:** As much as manufacturers want and need to keep up investments in strategic projects, they are forced to review their expenditures on new product programs and R&D

5. **Marketing & Sales Strategy:** Manufacturers are adjusting their products and marketing to the new constraints and demands of their customers

6. **Support for Suppliers Strategy:** Whose access to credit is even more critical, manufacturers scrutinize the situation of their key suppliers on a daily basis and provide support to the extent they can.

Finally: manufacturers are doing what they have to do to come out of the current crisis in a strong way, ready to take on future challenges. To make sure that we do not enter a prolonged period of recession, with the inevitability of wider and more permanent loss of employment and competitive strength, governments and institutions need to act urgently.

## REFERENCES


Josef Ackermann, (2008), The Subprime Crisis And Its Consequences, *Journal of Financial Stability*, 4, pp. 329-337.

Aghion, P., Bacchetta, P. and Banerjee, A., (2001), Currency Crises And Monetary Policy In An Economy With Credit Constraints, *European Economic Review*, 45, pp.1121-1150.

Brown, S., Goetzmann, W. and Park, J., (2000), Hedge Funds And The Asian Currency Crisis Of 1997, *Journal of Portfolio Management,* 26, pp. 95-101.

Chang, R. and Velasco, A., (1999), Liquidity Crises In Emerging Markets: Theory And Policy*, NBER Macroeconomic Annual*, pp. 11-58.

Chari, V. and Kehoe, P., (2004), Financial Crises As Herds: Overturning The Critiques, *Journal of Economic Theory,* 119, pp.128-150.

Corsetti, G., Dasgupta, A., Morris, S., and Shin, H., (2004), Does One Soros Make A Difference? A Theory Of Currency Crises With Large And Small Traders, *Review of Economic Studies,* 71, pp. 87-113.

Corsetti, G., Pesenti, P., and Roubini, N., (1999), What Caused The Asian Currency And Financial Crisis? *Japan and the World Economy,* 11, pp. 305-373.

Kaminsky, G., Reinhart, C., and Vegh, C., (2003), The Unholy Trinity Of Financial Contagion, *Journal of Economic Perspectives*, 17, pp. 51-74.

Kaminsky, G., Lyons, R., and Schmukler, S., (2004), Managers, Investors, And Crises: Mutual Fund Strategies In Emerging Markets*, Journal of International Economics,* 64, pp. 113-134.

Kim, W. and Wei, S., (2002), Foreign Portfolio Investors Before And During A Crisis, *Journal of International Economics*, 56, pp. 77-96.

Kodres, L., and Pritsker, M., 2002. A Rational Expectations Model Of Financial Contagion, *Journal of Finance*, 57, pp. 769-799.

Kyle, A., and Xiong, W., (2001). Contagion As A Wealth Effect, *Journal of Finance*, 56, pp. 1401-1440.

http://www.cheryinternational.com/news 22.03.2005)

http://www.fiatgroup.com/en-us/shai/banns/3/pages/default.aspx 25.03.2009)

http://www.gm.com/corporate/investor_information/cal_events/index.jsp 25.03.2009)

http://www.nissan-global.com/EN/DOCUMENT/PDF/FINANCIAL/TSE/2008/20083rd_tsefiling_243e.pdf 28.03.2009)

http://www.nytimes.com/pages/business/index.html 22.12.2008)

http://www.psa-peugeot-citroen.com/en/news/ 20.02.2009)

http://www.renault.com/en/Lists/ArchivesDocuments/Renault%20-Report.pdf 25.03.2009)

http://www.toyota.co.jp/en/ir/index.html 20.01.2009)

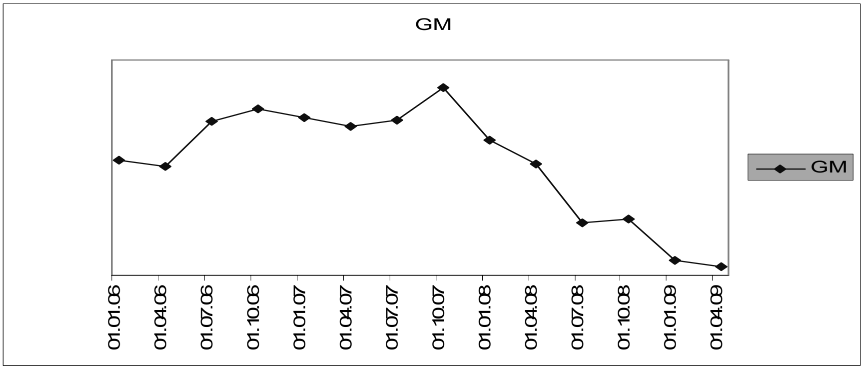
http://www.toyota.co.jp/en/ir/financial_results/2009/semi/summary.pdf 25.12.2008)

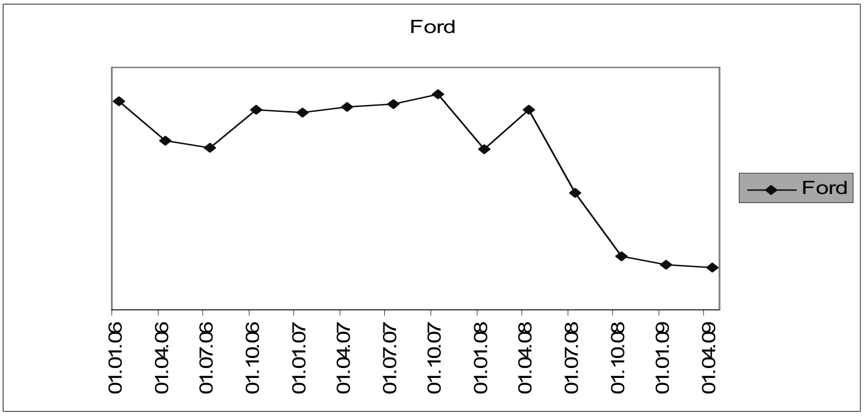
http://www.volkswagenag.com/vwag/vwcorp/content/en/investor_relations/share/key_figures_vw_share.html 25.03.2009

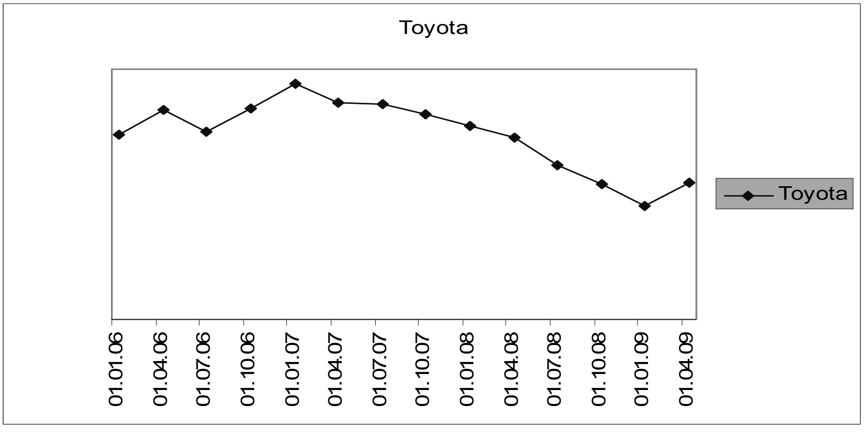
http://www.worldwide.hyundai.com/ 20.01.2009)

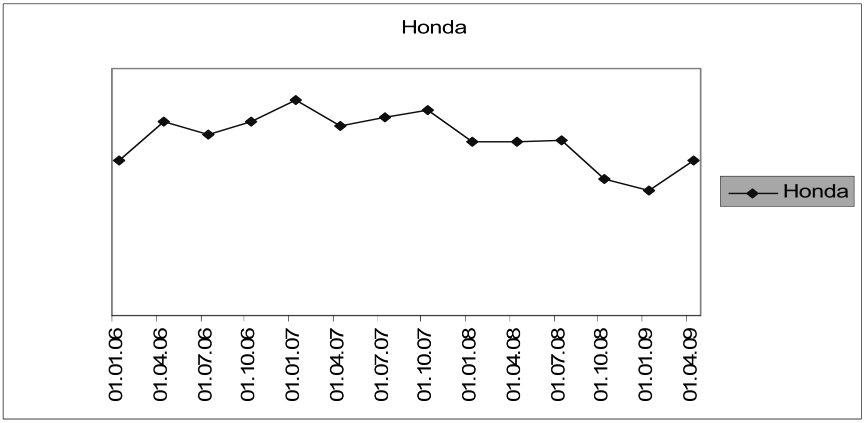
http://world.honda.com/news/2009/c090306Honda-Racing-F1-Team/ 06.03.2009)

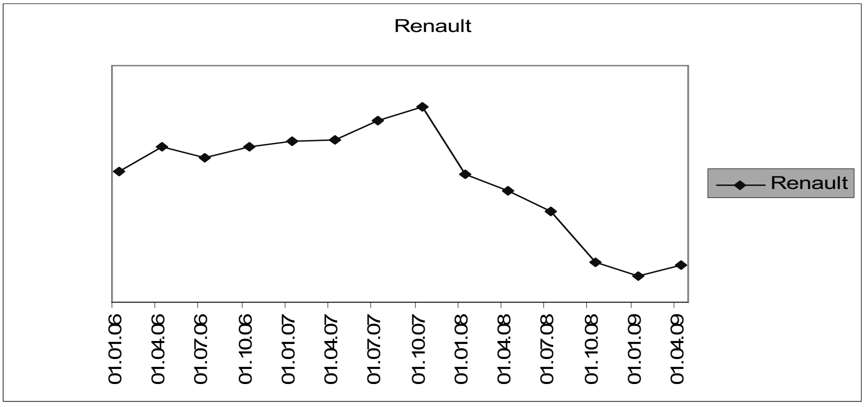
**Appendix 1**
**Changing's Share Price of Automotive Manufacturers**

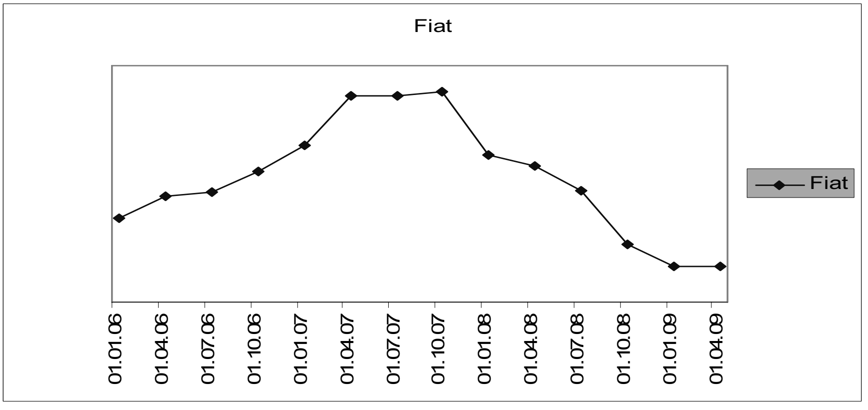


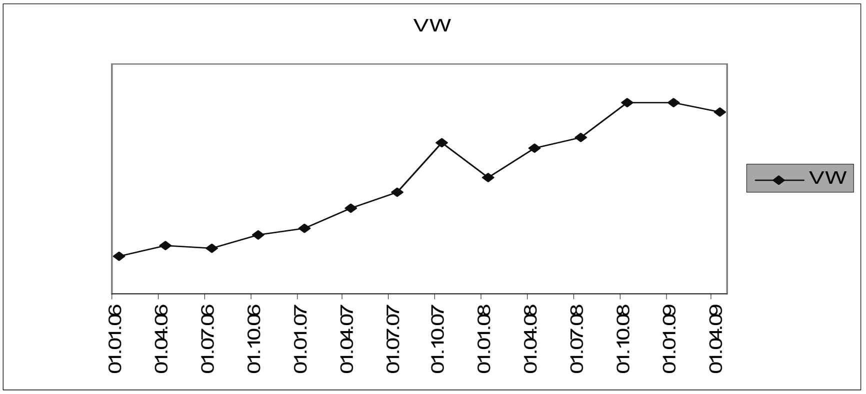



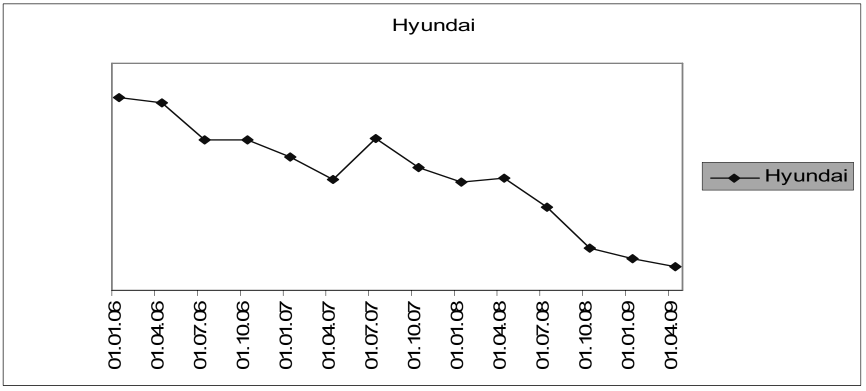



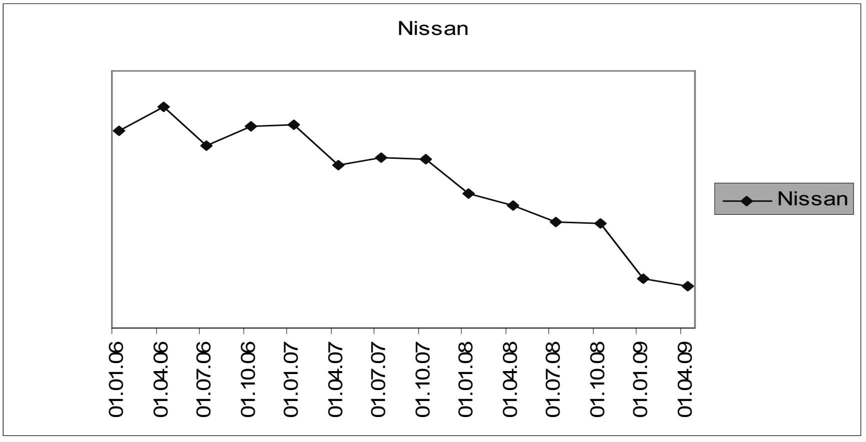

Honda
Honda
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09

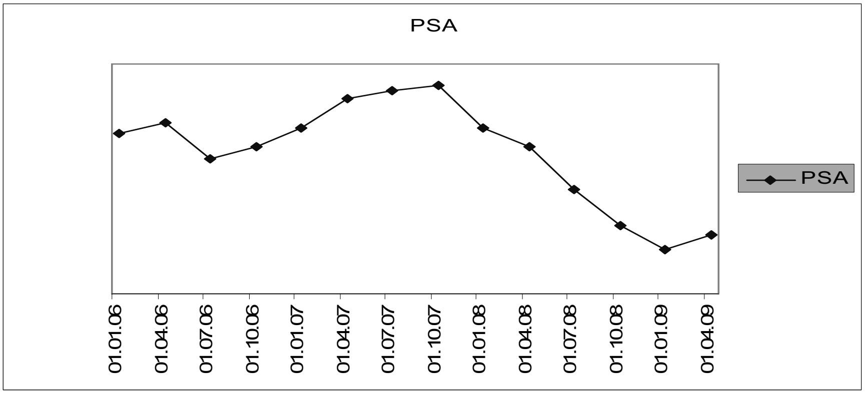

Renault
Renault
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09


Fiat
Fiat
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09


VW
VW
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09


Hyundai
Hyundai
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09


Nissan
Nissan
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09


PSA
PSA
01.01.06
01.04.06
01.07.06
01.10.06
01.01.07
01.04.07
01.07.07
01.10.07
01.01.08
01.04.08
01.07.08
01.10.08
01.01.09
01.04.09

## Appendix 2
## The Share Prices of Leader Automakers in World (1 January 2006-1 April 2009) for 14 Quarters

| | 01.01.06 | 01.04.06 | 01.07.06 | 01.10.06 | 01.01.07 | 01.04.07 | 01.07.07 | 01.10.07 | 01.01.08 | 01.04.08 | 01.07.08 | 01.10.08 | 01.01.09 | 01.04.09 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GM | 24,06 | 22,88 | 32,23 | 34,92 | 32,84 | 31,23 | 32,40 | 39,19 | 28,21 | 23,20 | 11,07 | 11,79 | 3,01 | 1,94 |
| Ford | 8,58 | 6,95 | 6,67 | 8,28 | 8,13 | 8,40 | 8,51 | 8,87 | 6,64 | 8,26 | 4,80 | 2,19 | 1,87 | 1,74 |
| Toyota | 103,71 | 117,13 | 105,22 | 118,00 | 131,78 | 121,42 | 120,63 | 114,44 | 108,32 | 101,50 | 86,05 | 76,09 | 63,51 | 76,47 |
| Honda | 28,24 | 35,43 | 32,92 | 35,33 | 39,33 | 34,43 | 36,02 | 37,43 | 31,54 | 31,75 | 31,99 | 24,77 | 22,66 | 28,14 |
| Renault | 77,70 | 92,00 | 85,55 | 91,65 | 94,95 | 95,72 | 107,60 | 115,90 | 75,79 | 66,05 | 53,71 | 23,86 | 15,16 | 21,74 |
| Fiat | 8,80 | 11,14 | 11,70 | 13,83 | 16,63 | 21,75 | 21,77 | 22,28 | 15,61 | 14,39 | 11,80 | 6,16 | 3,84 | 3,74 |
| VW | 48,90 | 62,11 | 58,75 | 77,30 | 85,51 | 111,39 | 132,54 | 197,90 | 151,59 | 189,39 | 204,76 | 248,50 | 249,45 | 237,00 |
| Hyundai | 29,68 | 28,90 | 23,15 | 23,25 | 20,50 | 17,15 | 23,35 | 19,00 | 16,63 | 17,28 | 12,75 | 6,53 | 4,98 | 3,64 |
| Nissan | 9,21 | 10,36 | 8,48 | 9,44 | 9,52 | 7,57 | 7,92 | 7,89 | 6,30 | 5,75 | 4,95 | 4,90 | 2,32 | 1,95 |
| PSA | 48,8 | 52,1 | 41,1 | 44,6 | 50,3 | 59,45 | 62 | 63,6 | 50,3 | 44,6 | 31,9 | 20,77 | 13,34 | 17,88 |

# GLOBAL ECONOMIC CRISIS MANAGEMENT FROM STRATEGIC MANAGEMENT AND MARKETING PERSPECTIVES: THE CASE OF TEXTILE INDUSTRY

**Esin BARUTÇU,**
**Pamukkale University, Turkey**
**Celalettin SERINKAN,**
**Pamukkale University, Turkey**
**Süleyman BARUTÇU,**
**Pamukkale University, Turkey**

## ABSTRACT

*The main objectives of this study are (1) to give a brief information about the reasons of the emergence of global economic crisis, (2) to analyze specific management and marketing strategies applied by the firms to alleviate the effects of economic crisis, (3) to elicit which those management and marketing strategies are preferred to overcome the effects of crisis and recover the textile companies, and (4) to discuss the management and marketing strategies implemented by textile manufacturers against the crisis. In accordance with the results of the research that was conducted on 37 textile companies, the global economic crisis emerging in September 2008 has already been devastating, and has affected the new investments, sales and employees of several textile companies and has also spread to the suppliers of those companies around Denizli-Turkey and the globe. The most favourable result of this research is that managers keep on struggling for eliminating negative effects of the crisis. Several strategies from decreasing the cost to acquiring new customers were identified as significantly related with overcoming economic crisis. According to informal negotiations, one of the main weaknesses of the companies participating in the research is their lack of a business plan and a strategic management process model for a crisis time as Preble (1997) suggested. Therefore, the most unfavourable result of the research is that managers do not have a specific business plan or model to prevent the negative effects of global economic crisis towards their companies.*

***Keywords: Strategic Alliances, Supply Chain Management, Strategic Supplier Alliances, Natural Stone Industry***

## INTRODUCTION

The variety of crises can impact companies from managerial to economic areas. Nowadays, there is an inevitable dramatic global economic crisis, which affects all the people on earth from manufacturers to consumers. This crisis started to show its effects at the last quarter of 2008, and has led to economic recession in many countries and a sharp increase in their unemployment level. Consumers, manufacturers, managers and employees are facing with one of the most serious global economic crisis started from the United States of America (USA), spread to European countries and threatened the whole world.

The crisis management is a very important field of management (Greening and Johnson, 1996; Preble, 1997; Lee and Makhija, 2009; Crisis Management, 2009) and marketing literatures (Cundiff 1975; Adler, 1975; Shama, 1981), because an ongoing global economic crisis has influenced many industries, manufacturers, distributors, retailers and consumers not only in Turkey but also in the world. Besides economists, this economic recession requires general managers to take actions for their competitiveness and marketing managers to modify their marketing strategy so as to keep their profits. Given global economic crisis, how managers should direct their companies, design their business plan, and choose strategic management and marketing strategies is very important. They generally mean determining and implementing strategic management and marketing strategies. Such marketing strategies often require a redefinition of the target markets and marketing mix, the "4P's" describing product, price, promotion and place to achieve marketing objectives. Such management strategies involve redefinition of mission statement, revision existing strategies and restructuring their company. Therefore, economic recession calls for marketing managers to use strategies for stimulating consumer demand, and the general managers to refloat their companies.

Instead of explaining crisis prevention strategies, this study has examined the responses of the managers to the global economic crisis and assessed their strategic management, marketing strategies and the process of restructuring their textile companies in the aftermath of the crisis of 2008. Thus, in the conceptual part of this study, the sources of the global economic crisis, its effect on companies and consumers, and crisis management in terms of strategic marketing and management are explained.

# CONCEPTUAL FRAMEWORK

The concept of the crisis can be defined as events characterized by threat, surprise, magnitude, with a need for a quick response and high potential costs if they are not resolved effectively (Greening and Johnson, 1996). In contrast, economic crisis can be defined as a long-term economic state characterized by unemployment, low prices and low levels of trade and investment referring to the sharp transition to a recession.

## Background to Global Economic Crisis

During the last quarter of 2008, as Europe and the United States headed an inevitable global economic recession, and academicians and managers have been paying close attention to it. The current global economic crisis began in 2007 because of the unpaid mortgage credits. The root cause of this crisis is the real estate market, and it was blamed on bankers' excessive leveraging of assets. As with the current crisis, both of these involved real estate bubbles ultimately burst. Losses from real estate ultimately deplete a bank’s capital by depleting stockholders’ equity (Udell, 2009). Although the financial industry in the US is one of the main reasons for global economic crisis, the economic recession has been shocking effects on many industries unrelated to the financial industry. Thus, global economic crisis effect has caused economic recession that is a trend of decreasing demand for raw materials, products, and services and weakening both consumer confidence and the consumer expenditure that has been buying the U.S. economy (Quelch, 2008). Therefore, this global economic crisis gained greater importance because many countries, companies and consumers have been affected by its intensity.

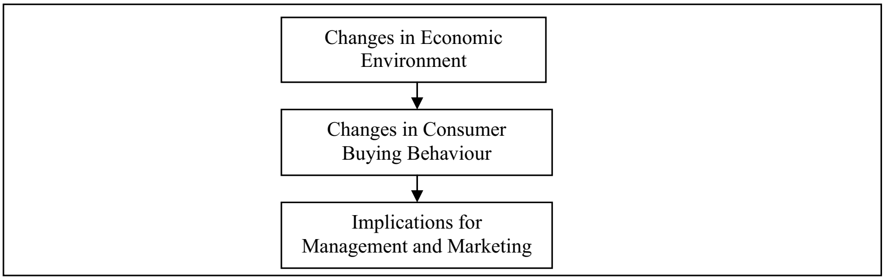
Since 2008, some of the stock markets such as New York Stock Exchange, Istanbul Stock Exchange and etc. have fallen, some financial institutions have collapsed or been bought out, and governments (USA, European Countries and Turkey) have had to come up with rescue packages to bail out their financial systems and companies. Finally, the global economy is teetering on the brink of recession and experiencing massive global demand destruction from automotive to textile industries. Because of the economic crisis, some of the banks and companies in the U.S. went bankrupt. For example, Lehman Brothers went out of business, Merrill Lynch was picked up in a fire sale by Bank of America, and AIG needed government assistance to stay afloat. The economic crisis can cause unpredictable downward shifts in the level of supply and demand and affects all consumers and companies.

## Global Economic Crisis’ Effect towards Consumers and Companies

It is easy for companies to generate a profit when economic conditions are favourable. The growths of the companies are more easily achieved, when the entire markets are growing. In contrast, it is not easy for companies to generate a profit, when economic conditions are unfavourable, and global economic recession occurs. There are many conceptual and empirical studies about how the crisis affects consumers and companies in many industries. The changes in the economic environment such as shortage, inflation, recession, and the various combinations thereof representing different types of stagflation, affect consumer realities and expectations concerning wages, employment, prices, products, and services. As seen in Figure 1, such an impact brings about changes in consumer attitudes and behavior, creating the different economic environment and consumer segments for companies (Shama, 1981).

Researches showed that consumers change their buying patterns under economic hardship because consumers become more unconfident about their job, they pay money for less of everything, decrease consumption and wastefulness. For example, Shama (1981) analyzed the responses of the New York City consumers to the oil crises in the 1970s and their aftershocks. His surveys suggested that the economic crises impacted consumers' motives, values, attitudes, and expectations. Similarly, Ang et al. (2000) analyzed the consumers' experience during the Asian crisis, and they found (1) reduction in overall consumption and wastefulness, (2) extended information search, (3) substitution by cheaper brands and generic products, (4) postponing to buy luxuries products, (5) purchasing local rather than foreign brands, (6) buying smaller packages, (7) preference for informative rather than imagery-based advertisements, and (8) popularity of discount and neighborhood stores.

**Figure 1. The Impact of Economic Ressesion on Consumers and Companies**




**Adapted from: Shama, A. (1981) Coping with stagflation: voluntary simplicity, Journal of Marketing, Vol.45 (3), p.121**

In a recession, similar to consumers, managers should struggle with decreasing sales and rising costs, so operations must be performed efficient enough in order to survive on lower profit margins. At this time, the managers could prefer various strategies to overcome crisis' negative effect. For example, they decrease production costs, try to sell cash in advance, and reorganize the company. For example, National-brand manufacturers usually cut back on advertising and cut back on marketing research (Lamey et al. 2007). However, instead of these precautions, they should keep marketing activities and maintain marketing budget. Successful companies do not abandon their marketing strategies in a recession; they adapt them (Quelch, 2008). In sum up, researches showed that consumers change their buying patterns under economic hardship and stress, and companies change their production, management and marketing strategies. Thus, the top management team should anticipate the changing conditions in the marketplace and choose appropriate management and marketing strategies.

## The Economic Crisis Management in Strategic Management and Marketing

The fields of crisis management and strategic management have been evolving separately despite their potential for synergistic integration (Preble, 1997). The crisis management is a relatively new field of management. The crisis management takes in hand to forecast areas of potential crises and minimize the negative effects of a crisis. In general, proactive crisis management activities include forecasting potential crises and planning how how to deal with them. Moreover, it includes identifying the real nature of a current crisis, and intervening to minimize damage and recovering from the crisis (Crisis Management, 2009).

According to Preble (1997) integrated strategic management process model in a crisis period, the strategy formulation process begins to develop a mission statement and then identifies company's key external opportunities and threats and its principal internal strengths and weaknesses (SWOTs). After this, crisis' audits are designed to examine the potential for failure in human, production, organizational, technological, social, political and macroeconomic systems, internal or external to the company. The next step in the process is to develop strategies, to take advantage of an organization's internal strengths, to minimize weaknesses, to fight with threats against company and to exploit opportunities emanating from the market environment. The next phase in the strategic management process is that of strategy implementation, which begins with the articulation of company policies. The final phase of the integrated strategic management process model is the evaluation of progress to date towards the achievement of strategies and crisis plans using feedback. Moreover, Lee and Makhija (2009) investigated the importance of strategic flexibility during an economic crisis to respond changing economic environments. Therefore, the global economic crisis requires benefiting and using some management and marketing strategies.

During a recession, marketing plays a key role in a number of decision areas. For example, when money is abundant, consumers will accept almost any price increase for popular products; but when money is short, demand for many products becomes price elastic. Likewise, promotion is more important during a recession. Because of a lack of confidence to the future of the economy, consumers are spending less and saving more of their income. Well-planned promotion can increase sales by helping to overcome this propensity to save. Product policies are also affected by a depressed economy: when consumers are reluctant to spend any money, they are unwilling to settle for products that do not precisely meet their need specifications (Cundiff, 1975). According to Adler (1975), there were some roles of marketing in a recession classified as to (1) devise new strategies and tactics to help sell off bloated inventories, (2) continue to invest in new product development, advertising, and sales promotion, (3) use the marketing intelligence function even more to understand consumer attitudes and behavior as a foundation for product policies, (4) develop integrated marketing plans, and (5) apply the marketing concept rather than pay lip service to it. According to Quelch (2008), marketing managers should keep in mind eight factors when making their marketing plans for 2008 and 2009 as (1) research the customer, (2) focus on family values, (3) maintain marketing spending, (4) adjust product portfolios, (5) support distributors, (6) adjust pricing tactics, (7) stress market share, and (8) emphasize core values.

From marketing perspectives, marketing strategies in an economic recession can be classified as market mix strategies: withdraw from weak markets, fortify in markets where brand is strong, acquire weak competitors, concentrate on simple and durable products, improve quality while maintaining price, avoid reducing quality and price, sell in discount and wholesale centres, consider alternative channels and markets, enhance promotions by offering discounts, hire more salespeople, bolster customer service, and emphasize faster delivery etc. (Ang et al. 2000). From management perspectives, managers and owners of companies focus on how to change their companies to overcome economic crisis. Management strategies in an economic recession can be classified as revising exisiting strategies, pursuing cost reduction, selling of assests, downsizing, outsourcing, building core competencies, reorganizing the company, reallocating their resources, diversifying the products and markets, changing supply chains, and forming strategic supplier alliances etc.

## Textile Industry in Denizli-Turkey

The textile industry (including ready-made clothing and appreal) is one of Turkey's locomotive industries, and there are some textile companies within Turkey's 500 largest companies. Thus, the textile industry has played a major role in Turkish economy and Denizli economy as well. Many workers in textile companies are employed in manufacturing bed clothes, pillowcase, towels, bathrobes, knitwear and apparels etc. Besides, textile companies faced fierce competition due to the increasing rate of exports of new industrialized countries (especially China, India, Egypt, Pakistan and Bangladesh etc.), whose low wages and labor cost give them a considerable competitive advantage. Then, this industry has been the scene of many downsizing and out of business activites since 2005, because of the fact that on January 1, 2005 the protective umbrella of textile quotas has been lifted in the world. Moreover, competitiveness of textile companies in Turkey is decreasing due to global economic crisis and worldwide recession, which is going worse.

Without a shadow of a doubt, the world textile industry will be affected by the latest global crisis because the orders and exports of textile products are diminishing. Though Turkey is the most important supplier of apparel and textile products, the growing crisis of the Turkish textile industry and other major manufacturing companies will lead to an inevitable contraction of the entire Turkish economy. Many Turkish textile companies (Sonmez Filament, Sancak Tul, Sifas and Poylen, Aksu Iplik, Dempa Denizli Mensucat and Denteks etc.) announced that they would permanently or temporarily halt the production. This decision is another indication that the Turkish economy has went into a deep and protracted decline, threatening the jobs and living standards of millions of employees. Further temporary and permanent plant closures and company failures are on the agenda in Bursa, Denizli and other Turkish cities, as the global financial and economic crisis deepens (İkinci, 2008).

# THE EMPIRICAL STUDY FOR DETERMINIG TEXTILE COMPANIES' STRATEGIC MANAGEMENT AND MARKETING STRATEGIES TOWARDS GLOBAL ECONOMIC CRISIS

To sum up, global competition in textile industry intensified after economic crisis in the world. During the last quarter of 2008 and the first quarter of 2009, managers of textile companies have been paying close attention to their own reactions. Nowadays, many managers of textile companies discussed how they can survive from this economic situation and increase their competitive positions. Some textile companies in Denizli have been shut down and some workers from textile companies have lost their jobs, because of the decreasing textile demand not only in Turkey but also in the world. Therefore, textile companies in Denizli are searching for new ways to survive their operations. Thus, it is important to determine how textile companies have been affected, and which/what strategies managers should adapt to better their competitive positions in this economic crisis period. Therefore, determining managers'reactions of textile companies to global economic crisis is very important.

# Research Methodology

This research has covered textile companies of the city of Denizli, Turkey. In order to elicit the managers'reactions of textile companies, primary data was collected through survey methodology, and a structured questionnaire was created. There were 8 questions and 43 items on four sections designed. In first section, the characteristics of respondents and companies were asked. In the second section, the effect level of global economic crisis was asked. In the last two sections, which management and marketing strategies were chosen by managers to overcome global economic crisis, and how well the managers of textile companies were handling the global economic crisis were asked. This questionnaire was pre-tested on the sample of three academicians and managers. In the sampling stage, because of the limited time, the sample size is determined as 50 managers or owners of textile companies. The survey was carried out on a sample of textile companies selected by judgment sampling method. 50 questionnaires were distributed. Afterwards, 37 respondents from several textile companies agreed to participate in the study by completing the survey in April 2009. In data analysis stage, the frequencies of the first 5 close-ended questions calculated on nominal scale, and means and standard deviations of questions calculated on Likert scale are given. The answers of which management and marketing strategies were chosen to overcome global economic crisis questions were coded and categorized for analysis purposes.

# Research Findings

Table 1 reveals the characteristics of companies and respondents participating in the research. In terms of the respondents' positions, 27% of 37 respondents were marketing managers, 21,6% were owners and general managers, 13,5% were operation managers of the participated companies. Among the 6 respondents marked the others, 6 (16,2%) respondents are the managers or human resource and finance departments. In terms of the respondents' education, of all the 37 respondets, 62,2% have undergraduate degrees. In terms of the company sizes, there are 17 companies employing less than 250 workers, 10 companies employing between 251 and 500 workers and 2 companies employed more than 1001 workers. Among the 37 companies, 35,1% have more than 7001 square meters, and 32,4% have between 5001 to 7000 square meters production areas.

**Table 1: The Characteristics of Companies and Respondents**

| Variable | N | % | Variable | N | % |
|---|---|---|---|---|---|
| *Respondent's Positions* | | | *Respondent's Education* | | |
| Owners | 8 | 21,6 | Primary School | - | - |
| General Managers | 8 | 21,6 | High School | 11 | 29,7 |
| Operation Managers | 5 | 13,5 | Undergraduate School | 23 | 62,2 |
| Marketing Managers | 10 | 27,0 | Graduate School | 3 | 8,1 |
| Others | 6 | 16,2 | *The production area* | | |
| *The number of workers* | | | ≤ 1000 square meters | 3 | 8,1 |
| ≤ 250 | 17 | 46 | 1001-3000 square meters | 5 | 13,5 |
| 251-500 | 10 | 27 | 3001-5000 square meters | 4 | 10,8 |
| 501-750 | 4 | 10,8 | 5001-7000 square meters | 12 | 32,4 |
| 751-1000 | 4 | 10,8 | ≥ 7001 square meters | 13 | 35,1 |
| ≥ 1001 | 2 | 5,4 | | | |

The global crisis is supposed to affect many industries. Table 2 reveals the influence of the crisis to textile companies, and shows means and standard deviations of responses. Fundamentally, the results reveal that all business functions influenced negatively except for their bargaining power toward suppliers. By the order of influenced negatively, global economic crisis affect their new investment, international sales, workers quantity, profit level, domestic sales, and production levels. Thus, the ongoing global financial crisis has impacted the textile industries in many ways from their new investments to price levels.

**Table 2: The effect level from Global Economic Crisis***

| The effects of the crisis to business functions | Mean | SD |
|---|---|---|
| Development level by new investments | 1,3784 | ,54525 |
| International sales | 1,4857 | ,56211 |
| The number of workers | 1,5459 | ,62120 |
| Profit level | 1,5946 | ,68554 |
| Domestic sales | 1,6667 | ,63246 |
| Production level | 1,6757 | ,74737 |
| Bargaining power toward customers | 1,7568 | ,76031 |
| Price level | 1,8649 | ,82199 |
| Bargaining power toward suppliers | 2,4324 | 1,04191 |

* Scale: A five-point Likert scale from 1.completely negative influenced to 5.completely positive influenced

Table 3 reveals main management strategies applied in global economic crisis by top management teams of textile companies. Generally, the participated managers focused on their production cost and productivity. Of all 37 respondets, 89,2% tried to decrease their costs, 67,2% increased their quality and productivity and 51,4% diminished their workers. Less than 43,2% concentrated on outsourcing and restructuring their companies to close or/and strengthen some of their departments. 27% tried to enter alternative industry from agriculture to machine industry. 16,2% invested vegetables in hothouses, 10,8% entered textile manufacturing and small and big cattle raising. 24,3% tried to establish supplier alliances and/or strategic supplier alliances with their customers and suppliers, because alliances could provide benefits to those companies, which can not survive alone.

**Table 3. Strategies for overcoming global economic crisis from strategic management pespectives**

| An array of main management strategies towards global economic crisis | N | % |
|---|---|---|
| Reducing production cost | 33 | 89,2 |
| More concentrating quality and productivity | 25 | 67,6 |
| Laying- off workers / mass layoff | 19 | 51,4 |
| Outsourcing | 16 | 43,2 |
| Restructuring of the company | 16 | 43,2 |
| Keeping their businesses | 13 | 35,1 |
| Entering alternative new industry | 10 | 27,0 |
| Closing some departments | 9 | 24,3 |
| Forming strategic alliances | 9 | 24,3 |
| Forming strategic supplier alliances | 9 | 24,3 |
| Changing objectives and targets | 7 | 18,9 |
| Merger with their customers | 7 | 18,9 |
| Strengthening some departments | 6 | 16,2 |

Analyzing jointly Table 1, Table 2, and Table 3, in terms of the number of workers and production areas, there is a discrepancy. When the number of workers and production areas are compared, it is verified that many big textile enterprises have more than 5001 square meters production areas reduced their workers.

Table 4 reveals that main marketing strategies applied in global economic crisis. First, respondents were in agreement that getting the new customers would be the best strategy. Among 37 respondents, 48,6% tries to get new customers from alternative markets and industries from the South Africa, Spain, the United Arap Emirates to Greece. Moreover, 56,8% differentiates their products, and 32,4% focuses on new/different textile products. Results also show that the government incentives in marketing have utmost importance. The main objectives of government incentives are to encourage exports, to develop the export markets, to support the participation in fairs/exhibitions abroad and to increase the competitive power of Turkish exporters in the international markets. A series of government incentives aiming to protect various industries from the impact of the ongoing global economic crisis are fairs, supporting market research, zero interest credit and R&D incentives. For example, R&D incentives are the activities which aim at producing a new product, improving the quality or standards of the product, applying new methods for increasing the standards and decreasing the costs, developing new production technologies. Of all 37 respondents, 54,1% uses fairs incentives in domestic and international fairs. 24,3% uses incentives for supporting market research for exports and zero interest credits for Small and Medium-Sized Companies (SMEs) (KOSGEB's Export Credit Support Program), 21,2% benefits from R&D incentives. Moreover, 51,4% tries to retain their customers and develops customer loyalty. The least preferred strategy is to employ more sales persons. Just 21,6% of the participated companies increased the number of the sales persons.

**Table 4. Strategies for overcoming global economic crisis from strategic marketing pespectives**

| An array of main marketing strategies towards global economic crisis | N | % |
|---|---|---|
| Getting new customers | 26 | 70,3 |
| Products diffrentation | 21 | 56,8 |
| Benefiting from state incentives | 21 | 56,8 |
| - Supporting fairs | 20 | 54,1 |
| - Supporting market research for exports | 9 | 24,3 |
| - Others incentives | 9 | 24,3 |
| - R&D incentives | 8 | 21,6 |
| Developing customer retention and customer loyalty | 19 | 51,4 |
| Entering new market/markets | 18 | 48,6 |
| Focusing new/different textile products | 12 | 32,4 |
| Offering more competitive price | 9 | 24,3 |
| Increasing international personel sales | 8 | 21,6 |

Analyzing jointly Table 2, Table 3, and Table 4, many of the managers try to apply generic types as differentiation, cost leadership, and focus or combination called as Porter's strategies (Porter, 2004). In the product differentiation strategy, a company focuses efforts on providing a unique product or service, setting their offerings distinct from their competitors' so as to charge a premium price to capture market share. In the cost leadership strategy, a company focuses their effort on decreasing their cost and markets a good quality product or service at a lower cost than competitors. Some of the textile companies used combined generic strategies. The cost focus strategy can be adopted by differentiators or cost leaders as the cost focus and differentiation focus. The participated companies try to reduce their cost so as to get lower price advantage, to differentiate the colours, styles and quality of their unique textile products. Moreover, forming the strategic alliance among rivals or strategic supplier alliances are some of the major ongoing interests of the respondents. They try to establish strategic partnership with their customers and suppliers.

26 respondents ranked five strategies in terms of priority from the most-preferred to the least-preferred with an ordinal measurement scale. According to their answers, the priorities of their strategies are (1) holding their companies, (2) entering to the new markets, (3) downsizing and decreasing their operational costs, (4) increasing their market share or (5) leaving textile industry. Thus, it is concluded that managers participated keep on struggling with the ongoing glabal economic crisis and its consequences.

# CONCLUSION

Turkish Government has repeatedly been stating that Turkish economy will not be probably affected as much as the countries in Europe and the USA. However, according to research results, industries and companies exporting their products have definitely been affected in Turkey because of decreased demands in the international markets. According to informal negotiations, the managers and owners of textile companies said to be in trouble and sought government supports. Besides govermantal supports and strategies, their own strategies of the textile managers played a critical role in overcoming criss effect.

Instead of evaluation of governmental strategies to overcome global economic crisis, management and marketing strategies should be identified because of providing management and marketing strategies and tactics for textile companies to survive and prosper in the current global economic crisis. From management perspectives, almost more than 70% of respondents considered that the best response to crisis was to decrease their cost and enter new markets and industries. Therefore, they focused on their production cost and productivity. Although one of the last strategy should be decreased their workers, most companies are making employees redundant. Marketing managers may need to offer more different and unique textile products not only existing markets but also entering new markets. Management and marketing strategies including strong focus on management and marketing strategies, increases their sales and decreases their cost applicable across recession contexts prevail in the Turkey and World. Thus, in our opinions, downsizing, decreasing production costs, entering to new markets, raising quality, lowering prices and focusing on new textile products not only in the international markets but also in domestic markets should be used efficiently so that the global economic crisis can be overcome with the least possible damage. Moreover, it should be borne in mind that some management and marketing strategies appropriate for implementing during good economic period may become ineffective when there is a recession or crisis in a country or in the world.

According to literature review and and research results, (1) the first imperative is to design a new business plan for economic crisis, (2) the second imperative is not to stop marketing activities, but search for decreasing their cost, (3) the third imperative is to restructure their companies for decreasing crisis effect. In the further researches, how a new business plan can be desiged for the global economic crisis should be analyzed because the companies need to prepare a new business plan for the global economic crisis.

# REFERENCES


Adler, L. (1975) "Nine roles of marketing in a recession", Comments from Our Readers, Journal of Marketing, Vol.39 (3), 78-79

Akan, O., Allen, R. S., Helms, M. M., Spralls III, S.A. (2006) "Critical tactics for implementing Porter's generic strategies", Journal of Business Strategy, Vol. 27 (1), 43-53

Ang, S. H., Leong, S. M., Kotler, P. (2000) "The Asian apocalypse: crisis marketing for consumers and businesses", Long Range Planning, Vol.33, 97-119

Barutçu, S. (2007) "Manager's Attitudes towards Strategic Supplier Alliances in Textile Supply Chain", 5th International Logistics and Supply Chain Congress, November 8-9, Okan University İstanbul-Turkey, 31-39

Crisis Management (2009) Retrieved April 5, 2009 from http://crisismanagement.in/

Cundiff, E. W. (1975) "What is the role of marketing in a recession?", Journal of Marketing, Vol. 39 (2), 1

Greening W. D. Johnson, R. A. (1996) Do Managers and Strategies Matter? A Study in Crisis, Journal of Management Studies Vol. 33(l), 25-51

Hitt, M. A., Ireland, R. D., Hoskisson, R.E. (1995) Strategic Management Competitiveness and Globalization, West Publishing Company, USA

İkinci, S. (2008)Turkey: Financial crisis hits textile industry, Retrieved April 15, 2009 from http://www.wsws.org/articles/2008/nov2008/turk-n11.shtml

Kotler, P. (2000) "Marketing Management, International Edition, Prentice Hall, Englewood Cliffs, NJ, USA

Lamey, Lien, Barbara Deleersnyder, Marnik G. Dekimpe and Jan-Benedict E.M. Steenkamp (2007), "How Business Cycles Contribute to Private-Label Success: Evidence from the U.S. and Europe," Journal of Marketing, Vol. 71(1), 1-15

Lee, S. H., Makhija, M. (2009) Flexibility in internationalization: is it valuable during an economic crisis? Strategic Management Journal, Vol. 30 (5), 537-555

Mandell, M. (1998) "Asia: converting crisis to opportunity" World Trade, April, 36-39

Porter, M. E. (2004) Competitive Strategy: Techniques for Analyzing Industries and Competitors, The Free Press, New York, USA

Preble, J. F. (1997) Integrating the Crisis Management Perspective into the Strategic Management Process, Journal of Management Studies, Vol. 34 (5), 769-791

Quelch, J. (2008) "Marketing Your Way through a Recession", Harvard Business Online, Retrieved April 8, 2009 from http://hbswk.hbs.edu/item/5878.html

Shama, A. (1981) "Coping with stagflation: voluntary simplicity", Journal of Marketing, Vol.45 (3), 120-134

Udell, G. F. (2009) "Wall Street, Main Street, and a credit crunch: Thoughts on the current financial crisis", Business Horizons, Vol.52, 117-125

# NIGHTMARE OF INSURANCE DIRECTORS: EFFECTS OF GLOBAL CRISIS ON TURKISH HEALTH INSURANCE BUSINESS

**Ayça TÜKEL**
**Onur YARAR**
**Oğuz ÖZYARAL**

**Okan Üniversitesi, Istanbul, Turkey**

## ABSTRACT

*Will Global Crisis affect insurance companies as much as banks? As principal source of crisis is finance sector, it is believed that negative effects may be less severely experienced by companies with strong financial structure, which had accurately directed investments. It is proposed that their profit abilities will not be affected as much as non-insurance financial organizations due to strong financial structures of insurance companies and lack of liquidity and capital requirements (TSEV, Turkish Insurance Institute,2008) It is inevitable that revenue of insurance companies will decrease, but their long-term commitments are accepted as a balancing factor which may ameliorate said decrease in income.(Deming, 2000) When effect of global crisis on insurance sector is examined, it will be a congruent approach divide insurance companies into two groups including "insurance companies insuring financial products" and "insurance companies in traditional terms". If we continue our examinations within this context, it is obvious that actual effects of crisis are felt by companies insuring financial products. In our country, products for insuring financial risks are scarce. Reassurance request in concerning field is limited. Consequently, when the sector is viewed from holistic perspective, it is estimated that negative effects of crisis will be lower.*

*Insurance sector in Turkey had reached two times gross domestic product within last five years. While growth estimation of authorities for 2009 is around 10-12% due to global crisis and current political problems, inflation-corrected real growth estimates correspond to zero or even negative values. Although crisis periods are perceived as an advantageous period for companies with sound financial structure, main challenge experienced during those periods is ability to determine sale price of product. Although no problem is encountered by insurance companies in terms of renewing policies within such periods, market conditions complicate purchasing new product. Current data obtained from Association of Reinsurance Companies of Turkey indicates increase in policy sale despite decrease in premium production. This condition directs companies towards harsh price competition for avoiding portfolio loss. At this point, reliability felt by clients and service quality are of vital importance for sustainability of insurance companies.*

*While health insurance business in Turkey is initially examined in conjunction with branches such as life assurance, health insurance had gained solitary importance due necessity for structuring life assurance and pension as separate branches. During 2000s, crisis environment specific to our country had caused narrowing in personal and corporate health insurance sector, however, a progression was observed in following years. Within last two years, contracts entered into by and between Social Security Institution (SGK) and hospitals had decreased personal and corporate interest to private health insurance. Another factor triggering said decrease is inability to completely implement supplementary health insurance applications. Global crisis with effects started to be felt within 2008 had forced companies to take saving measures. As a result of saving measures, part of corporate health insurance renewal agreements, which are generally executed at the end of year, could not come into effect and limitations and discounts were applied to remaining agreements. In this study, it is aimed to develop future perspective by analyzing effects of global crisis on health insurance business and to provide help to insurance directors at decision-making phase. In resultant sector analysis, main source was official data obtained from Association of Insurance and Reinsurance Companies of Turkey.*

***Keywords:****Global Crisis; Insurance; Health Insurance; Finance sector*

# INTRODUCTION

Today, insurance sector turned to be among principal structures of finance sector, besides sharing and distributing similar risks as well as funding the loss if the risk occurs. Finance institutions provide support to real sector by promoting savings, increasing liquidity and contributing to efficient distribution of resources. A financial system operating substantially and in harmony with real sector is one of most important components of economic development and stability.

Economic development and stability is closely related to economic capacity creation capacity. Insurance sector plays an important intermediary function in creating fund required for investments. Insurance companies retains collected premiums as guarantee for indemnity requests which may occur in the future and those companies direct part of those guarantees to capital market and thus, they enable investors to meet with savings.

This financial intermediary role is very important particularly for bridging investment gap in developing countries. In such countries, infrastructure projects requiring tremendous funds can be more easily realized by support of insurance sector. On the other side, in developing countries, considerable part of economy is comprised of small- and medium-scale enterprises. Financial status and substantial development of such enterprises will be associated with economic development. Insurance sector decrease risk and ambiguities possibly encountered by small- and medium-scale enterprises besides large scale enterprise, and thus, the sector contributes to development of small- and medium-scale enterprises. Resultant trust environment will promote increase in production, innovation and commerce. Due to above mentioned functions, insurance sector may also be defined as a production factor.

Development level insurance sector is parallel to level of economic development. In developed countries, insurance sector is a significant fund resource for economy. In such countries, insurance sector and also banking are most frequently used financial intermediary services; thus, contribution of insurance sector to economy is very significant[1]

On the other side, in developed countries, function of collecting savings and cycling them to economy is principally undertaken by banking sector (Oksay, 2004). But, a financial system developing only by one aspect cannot be deepened enough and thus, it become rigid against internal and external shocks. This is the principal factor leading developing countries to financial crisis.

Financial instabilities had become among one of most significant features of world economy within last two decades. Frequently occurring crisis load permanent effects on developing countries which particularly have economies built on fragile balances. Recent global crisis keeps all actors of Turkish economy, which is still among developing economies, under pressure. As it is the case for last several crisis, visible effects of crisis are felt by finance sector, however, principal effects are particularly undertaken by real sector. Results of crisis felt by real sector, which is highly important from macro-economic perspective due to its ability to create employment, are not limited within economic level (Yalçın, 2005: 83-84).

Mostly used as synonym of conjuncture and depression, crisis implies that several unpredictable developments cause several results which may affect government at macro-economic level and which may severely affect corporations at micro-economic level (Aktan, 2004). In 2007, although it was not predicted that negative advances originated from U.S. housing sector created domino effect and thus, it led to a global crisis, it is still unclear where this crisis affecting whole world by turning into a global problem will be ended and what will be the extent of this crisis in terms of damage. Being 17$^{th}$ economy of the world and 7$^{th}$ economy of the Europe and increasingly integrating into global economy, Turkey started to feel effects of crisis more severely as of first quarter of 2008. Despite all kinds of ambiguities, it is believed that severity of crisis will not be decreased before second half of 2009. Christopher Buckley, Senior Vice Director in charge of European and Asia-Pacific countries, from Airbus, which is a global player in a sector predicted to be severely affected from crisis, had stated their belief that advances through improvement will not be felt before spring of year 2010 (HT, Economy, 22.03.2009: 11). In our country, while 1994 and 2001 crisis had directly affected financial sector, 2008 global crisis also incorporated real sector. While global aspect of crisis was resulting with decrease in long-term monetary movement such as direct foreign capital entry to our country and portfolio investments, our chronic current deficit problem leads to concerns about how foreign finance required for removing the problem will be supplied.

[1] 1 Fortune 2000 Global 500 data 2000

Although success in crisis management brings a success potential in interior and foreign politics field, a possible failure may create social and even political traumas by deepening the problem of unemployment.

Today, most widely recognized and universal definition of health has been offered by World Health Organization (WHO). According to this definition, health does not only imply “lack of disease or infirmity, but it also covers complete well-being including mental and social well-being”. Regarding this definition, besides difficulty in explaining concept of well-being, it is also challenging that how will the “complete” be measured. On the other hand, regarding health as a status such as well-being will reduce responsibilities and task of the individual and thus health is reduced to a static condition. Besides all above mentioned issues, concept of social well-being included in the definition is regarded as a significant advance (Hayran, 1997:5). Moreover, in the light of this definition, all services offered for protecting, developing, improving health and for treating patients and rehabilitating disabled people are collected under a common concept, namely “healthcare” (Tengilimoğlu, 2009:35).

Healthcare requires harmonization between organizations offering healthcare services (such as hospitals, outpatient clinics) and institutions financing healthcare services. Finance of healthcare service is possibly provided by either government or individuals. Individuals may finance healthcare services by direct payment or via companies operating in private health insurance field. Private health insurance business develops as long as economic and socio-cultural status improves. (Symposium notes 2009).

Aim of this study addressing a hot and up-to-date topic is to reveal effects of global crisis on health insurance business under subtitle of macro-economics of insurance sector, which is one of principal constituents of finance sector, to make a general assessment depending on findings obtained from examination of data provided by official resources and to provide parallel recommendations.

# Crisis

Crisis is defined as a stress condition threatening present values, aims and assumptions of governments and corporations, because several unanticipated or unpredicted developments required to be responded quickly and immediately compromise prevention and adaptation mechanism of enterprises at micro level and of governments at macro level (Dinçer, 1998: 385, Aktan, 2004). Mostly regarded as synonym of conjuncture and depression in social sciences field, although crisis is a reality observed in many fields including God Events, health, economy, politics and governance, the study will particularly argue crisis in relation with health insurance sector.

It is widely recognized that preventive measures, rather than remedial solutions, are more efficient methods for solving crisis arising from sudden negative effects of internal or external environment and from interaction of internal and external environment. However, just as it is the case for God Events, economic crisis may sometimes emerge by defeating all assumptions besides all preventive mechanisms and thus, they cause tremendous losses including goods, money and reputation. Although it dos not seem it is completely possible to prevent crisis, extent of harmonization between aim and needs of the organization and conditions dictated by external environment decreases possibility of the organization to encounter crisis and to be crushed under effects of crisis.

First considering necessity to reveal which conditions should be referred as a crisis, it is worth to state that most significant feature of crisis is sudden, unpredictable and unknown occurrence. Nevertheless, crisis can spread in a similar manner with communicable diseases. Accordingly, a particular crisis occurred in any organization may enlarge its effect towards other sectors. In other words, crisis felt by a particular organization may also lead other organizations in relation with affected organization towards crisis. Another feature of crisis, regarded as a cute character of crisis by optimist administrators, is that crisis creates new opportunities, despite danger and threats against individuals and organizations. At this point, it should be kept in mind that when it is appropriately assessed, our crisis may offer a unique opportunity for another corporation and vice versa. Finally, knowing that crisis may be short or long-term reminds us that while we shape of our action plans to overcome crisis, we should plan all possible alternatives according to different time intervals.

Ability to expose less danger and to gain most benefit from opportunities throughout crisis period can be ensured only by an efficient crisis management. Crisis management is a process where signals of crisis are sensed against possible crisis condition, they are evaluated and necessary measures required for enabling the organization to overcome the crisis are taken and implemented. Stating that principal aim of the crisis management is to prepare organization against crisis condition, Can (1997: 315) had argued crisis

management process in five steps; sensing signals of crisis, preparation for crisis and protection, controlling crisis, transition to normal conditions and finally learning and assessment.
On the other side, installation of early warning system decreasing effects of possible crisis before it occurs, preparing policies and plans to be followed during crisis by recognizing reality of crisis and creating activities for rapidly responding crisis and remedying results of the crisis are recommended as critical steps to be followed in policies implemented for managing crisis (Bozgeyik, 2008: 51). In fact, it is obvious that crisis had almost occurred when first signals of crisis are sensed. Considering this finding, installation of early warning systems against crisis appears as most significant step of preparation to crisis. Today, there are some positive advances are present that administrators recognize that fact that measures taken for overcoming the crisis, in fact, are outcomes of above mentioned preparations.

Moreover, ability to determine reasons causing the crisis brings about significant clues for resolving crisis. Within this context, it is vitally important to recognize ourselves, competitors, close and general environment, to comprehend borders of global and regional competition, to assign resources suitable for sectors where environmental opportunities can be valued, to keep communication channels open, to create an efficient information gathering network, to apprehend technological and economic trends and to be within change process.

Ability to be within change process and to adopt new strategies and perspectives will necessarily bring about re-structuring requirements. We may define principal change management methods to be applied for overcoming crisis as follows; downsizing, reducing operational ranks, reaching optimal size and applying simple organization models, benchmarking, exploiting outsources and statistical process control.

Although all above mentioned techniques are well-known by administrators who had attended education in financial and administrative sciences, it is observed, unfortunately, that managers head towards economizing measures in present crisis, as they had done throughout 1994 and 2001 crisis. However, although many organizations attempted to decrease labor force for increasing efficient of employees by reducing employment costs, studies conducted during last crisis period had shown that managers of companies frequently estimates cost of this downsizing would be less, but they cannot reach desired outcome (Hutchinson, Murrmann and Murrmann, ).

According to results of a downsizing research performed by American Management Association, more than half of downsized companies reported that their profit shares had not increased (Greenberg, 1991). However, it is anticipated that as it is the case for today, downsizing strategy will be widely utilized in the future as a tool for reducing costs and for restructuring the organization. On the contrary, the author of Out of the Crisis, Deming, who is widely recognized and referred by whole world for defining right connection out of the crisis, recommends organizations towards strengthening of present human resources and managing human resources in an efficient manner; institutionalize on-the-job training, support training for everybody and for developing yourself and institutionalize leadership.

On the other side, establishing a perfect organization resistant to crisis before it occurs will lead to an effect which resists the crisis and delays initial waves of the crisis. Within this context, installation of early warning system, facing bitter realities, creating a cultural environment where realities are obviously stated, developing discriminative basic capabilities, development of continuous improvement mechanisms, exploiting technology only at required scale, investing on continuous training activities relating with intellectual capital and skills and thus creating providing opportunity for radical changes should be addressed as significant steps to create perfect organizations (Peters ve Waterman, 1995).

## A Glimpse to Turkish Insurance Business Sector

Insurance business in Turkey have been founded and developed under supervision of foreign capital companies. In Republic period, first insurance company with totally domestic (private) capital was found in 1942. In future period, number of insurance companies had increased in parallel to economic development. Between 1963 and 1980, several measures were taken for developing, regulating and auditing insurance sector. Among decisions made within said period, only procedure put into force was that number of companies would be prevented to hinder (unfair) competition between companies of said period (Oksay, 2004). Accordingly, pursuant to a resolution, entrance of new companies to the sector was hindered between 1968 and 1984. Aim of the resolution was preventing dissolution of insurance portfolio, which was in fact very small throughout said period, however, said measure did not bring about desired outcome and it led

companies towards laziness and prevented new advances. Within said period, number of companies was stayed around 38 and fund depositing rates had stayed at negative values at several years due to intense audit and control of government on funds of insurance companies (Kazgan vd., 1999).
Throughout financial liberalization in ‘80s, insurance activities had increased due to regulations made on insurance sector. As of early ‘90s, number of insurance companies rapidly increased. However, 1994 and 2001 crisis experienced by Turkish economy had also affected insurance sector. Throughout periods following years of crisis, number of insurance companies had shown fluctuation as some of them were gone bankruptcy or they were liquidated and for several other companies, authorization to issue new policy agreement was cancelled by Under-secretariat of Treasury. On the other hand, insurance companies were obliged to make tremendous indemnities due to1999 Marmara Earthquake. Ratio of indemnities paid in 1999 to total of premium was realized as 114.27 percent and it followed a level around 65 percent in following periods.

Totally 52 insurance companies, including 30 with foreign partner, are present in 2009 in Turkey. Considering said 30 companies with foreign capital support, 18 became foreign companies within last three years. As Turkey is ranked in first order among European countries in terms of long-term policy productivity rate, attracts attention of particularly European insurance companies to our country.

| **Market share of first 20 companies, 85 percent** | | |
|---|---|---|
| **Company** | **Total production** (YTL) | **Market Share** (%) |
| Axa | 833.166.294 | 10,73 |
| Anadolu | 738.143.171 | 9,45 |
| Koç Allianz | 626.849.104 | 8,03 |
| Aksigorta | 598.133.178 | 7,66 |
| ErgoIsviçre | 481.645.121 | 6,17 |
| Güneş | 472.803.931 | 6,06 |
| Yapı Loan | 401.567.497 | 5,14 |
| Başak Groupama | 355.828.726 | 4,56 |
| Eureko | 316.851.169 | 4,06 |
| T.Genel | 238.512.693 | 3,05 |
| Anadolu Life Emeklilik | 234.599.896 | 3 |
| Başak Groupama Emeklilik | 225.680.315 | 2,89 |
| Fiba | 213.997.706 | 2,74 |
| Aviva | 163.355.353 | 2,09 |
| Güven | 158.474.342 | 2,03 |
| AIG | 131.945.848 | 1,69 |
| Ankara | 130.797.316 | 1,68 |
| Zurich | 105.669.686 | 1,35 |
| HDI | 103.868.504 | 1,33 |
| AvivaSA | 102.327.077 | 1,31 |
| FIRST 20 COMPANIES | 6.639.216.927 | 85,03 |

Insurance Sector, Health Insurances and “Global Crisis”
In glossary definition, crisis implies a “stress” condition which is
- Not anticipated,
- Not previously sensed,
- Required to be rapidly and immediately responded,
- Threatens present values, assumptions and targets by compromising prevention and adaptation mechanisms

Global economic crisis first started with collapse of subprime mortgage loan market in U.S. in October of 2008 and then, it started to expand effects to cover Europe and it had completely negative effect on health sector as in all other sector.” Increase in exchange rates increased costs of drugs and disposables in the sector trading with foreign currency. It negatively affected production and investment costs. Energy expenditure, another cost item dependent on U.S. dollar, was also victim of the crisis.

Although health is inevitable and preferential for individuals, economic conditions arising from present crisis even caused said vital requirements are delayed.
Non-postponable healthcare requirements are provided by making concessions on quality.
Under these conditions, institutions with prior aim of providing quality healthcare service are forced to make concession on quality.

TURKISH INSURANCE SECTOR BASED ON POLCIY NUMBERS

| ***BRANCHES*** | ***Policy numbers 2007/9-month*** | ***Policy numbers 2008/9-month*** | ***Increase (%)*** |
|---|---|---|---|
| ***Fire*** | ***1.675.939*** | ***1.937.822*** | ***15,63*** |
| ***NDIA*** | ***1.801.614*** | ***2.162.180*** | ***20,01*** |
| ***Transportation*** | ***1.078.730*** | ***1.089.687*** | ***1,02*** |
| ***Accident*** | ***2.997.379*** | ***3.188.301*** | ***6,37*** |
| ***Highway Motor Vehicles Liability Insurance*** | ***7.857.589*** | ***8.701.132*** | ***10,74*** |
| ***Engineering*** | ***491.178*** | ***858.029*** | ***74,69*** |
| ***Agriculture*** | ***309.062*** | ***345.205*** | ***11,69*** |
| ***Health **** | ***1.298.026*** | ***1.719.843*** | ***32,50*** |
| ***Legal protection*** | ***680.708*** | ***872.850*** | ***28,23*** |
| ***Personal Accident **** | ***10.435.571*** | ***15.180.316*** | ***45,47*** |
| ***Loan*** | ***140.499*** | ***8.690*** | ***-93,81*** |
| ***Life **** | ***9.191.782*** | ***11.234.373*** | ***22,22*** |

SUM OF PREMIUMS ACCORDING TO BRANCHES IN INSURANCE SECTOR

| ***BRANCHES*** | ***2007/9-month (TL)*** | ***2008/9-month (TL)*** | ***Increase (%)*** |
|---|---|---|---|
| ***Fire (including NDIA)*** | ***1.238.236.836*** | ***1.358.501.038*** | ***9,71*** |
| ***Transportation*** | ***274.269.417*** | ***317.472.600*** | ***15,75*** |
| ***Accident*** | ***2.623.248.594*** | ***2.544.699.150*** | ***-2,99*** |
| ***Highway Motor Vehicles Liability Insurance*** | ***1.178.618.247*** | ***1.531.648.422*** | ***29,95*** |
| ***Engineering*** | ***384.737.573*** | ***394.619.899*** | ***2,57*** |
| ***Agriculture (Including TARSİM)*** | ***81.694.415*** | ***114.246.987*** | ***39,85*** |
| ***Health*** | ***865.481.321*** | ***957.894.757*** | ***10,68*** |
| ***Legal Protection*** | ***27.907.275*** | ***23.947.098*** | ***-14,19*** |
| ***Personal Accident*** | ***287.755.937*** | ***353.761.269*** | ***22,94*** |
| ***Loan*** | ***12.552.758*** | ***30.043.697*** | ***139,34*** |
| ***Total, non-Life*** | ***6.974.502.374*** | ***7.626.834.917*** | ***9,35*** |
| ***Life*** | ***1.054.394.145*** | ***1.230.306.417*** | ***16,68*** |
| ***SUM*** | ***8.028.896.519*** | ***8.857.141.334*** | ***10,32*** |

INDEMNITY/PREMIUM RATIOS IN BRANCHES OF INSURANCE BUSINESS

| ***BRANCHES*** | ***2007/9-Month (%)*** | ***2008/9-Month (%)*** |
|---|---|---|
| ***Fire*** | ***44,08*** | ***38,54*** |
| ***Transportation*** | ***37,75*** | ***49,94*** |
| ***Accident*** | ***74,85*** | ***79,31*** |
| ***Highway Motor Vehicles Liability Insurance*** | ***85,26*** | ***105,88*** |
| ***Engineering*** | ***50,15*** | ***79,79*** |
| ***Agriculture*** | ***19,85*** | ***63,97*** |
| ***Health*** | ***81,65*** | ***84,04*** |
| ***Legal Protection*** | ***1,18*** | ***6,39*** |
| ***Personal Accident*** | ***16,12*** | ***21,21*** |
| ***Loan*** | ***40,33*** | ***108,77*** |
| ***Total, non-Life*** | ***66,87*** | ***75,06*** |

TECHNICAL PROFITS BASED ON BRANCHES

| ***BRANCHES*** | ***2008/ 9-Month (TL)*** | ***2007 Increase according to 9-month (%)*** | ***Technical profitability ratio 2007/9 (%)*** | ***Technical profitability ratio 2008/9 (%)*** |
|---|---|---|---|---|
| ***Fire (including NDIA)*** | ***167.292.422*** | ***104,98*** | ***6,59*** | ***12,31*** |
| ***Transportation*** | ***76.982.179*** | ***14,80*** | ***24,45*** | ***24,25*** |
| ***Accident*** | ***166.561.039*** | ***190,75*** | ***2,18*** | ***6,55*** |
| ***Highway Motor Vehicles Liability Insurance*** | ***-278.645.676*** | ***53,62*** | ***-11,03*** | ***-18,19*** |
| ***Engineering*** | ***43.094.042*** | ***70,49*** | ***7,29*** | ***10,92*** |
| ***Agriculture (Including TARSİM)*** | ***-1.218.494*** | ***583,18*** | ***-5,05*** | ***-1,07*** |
| ***Health*** | ***19.255.287*** | ***11,82*** | ***0,33*** | ***2,01*** |
| ***Legal Protection*** | ***16.417.563*** | ***60,53*** | ***52,61*** | ***68,56*** |
| ***Personal Accident*** | ***156.481.616*** | ***705,27*** | ***33,88*** | ***44,23*** |
| ***Loan*** | ***-5.348.745*** | ***114,40*** | ***7,04*** | ***-17,80*** |
| ***Total, non-Life*** | ***360.871.235*** | ***67,24*** | ***3,09*** | ***4,73*** |
| ***Life*** | ***50.864.294*** | ***- 66.80*** | ***14,53*** | ***4,13*** |

When we perform a general assessment based on results
According to 9-month data of year 2008;

- Total premium production increased by 0 percent,
  However, sector downsized by 1 %, as inflation rate was 11 percent,

- ✓ It is anticipated that increase in premium production rate at the end of 2008 will be lower than inflation rate and the trend will continue throughout 2009.
- ✓ As it is expected that both crisis and crisis-related effect will be deepened, problems are predicted to occur in terms of premium collection in following periods.
- ✓ Although an increase is experienced in health branch, same trend cannot be realized in premium production. This finding reveals that a price competition is rushed up for not losing present clients.

# CONCLUSION AND RECOMMENDATIONS

There is a general expectation in finance sector that effects of present crisis will continue for a while. When we briefly address those expectations; governments should take more protective measures considering that period of low interest rate and high liquidity has ended, growth values will decrease parallel to liquidity and loan reduction, restructuring of global banking system is required, free market economy should transited to relatively more rule-dependent market economy and national economy should be protected.

When macro-economic data on Turkish economy is examined, Industrial Production had decreased by 13,9 percent in November, which was also decreasing since August 2008. Moreover, it seems that exportation, regressed by 20 percent in November, and economic constriction, which had started in 4th quarter of 2008 as it is indicated by November Customer Confidence Index characterizing future expectations, will continue in second half of Year 2009.

Infection rate of crisis is closely related with the extent of organization's interactions with economic environment, external dependence of the organizations and strength of equity capital. Within this context, whether effects of crisis on organizations will be long or short term is dependent on acceptance of crisis by administrators and on strictly implementing preventive measures in a timely manner.

On the contrary to 2001 crisis, Turkish economy experiences present crisis with better public finances arising from improvements, much more better banking and insurance system and more robust audition and monitoring in financial system. Those key strengths are positive factors relieving effects of crisis. On the contrary, foreign loan load on real sector is high and it is still increasing and chronic current deficit is also raising and these two factors attract attention as drivers rising risk. When positive and negative factors are examined in combination, it is believed that exposure level of our country will be relatively low than that of U.S. and European countries, if conscious and constant crisis management is followed.

Ability to benefit from opportunity aspect of crisis, which is comprised of opportunity and hazard, and to get positive outcomes from crisis requires immediate action and active intervention of government (Dinçer, 1998: 401) as well as preventive and corrective measures are timely determined and implemented after causes, effects and direction of crisis is deeply analyzed. Not only a powerful economy is required but also a stable financial administration is needed for taking said measures at macro-economic level. At this point, issue required to be taken into consideration is waste of resources and time by using same methods and tools for overcoming crisis, although it was revealed that strategies and implementations adopted before occurrence of crisis were not adequate to prevent crisis.

Ability to increase domestic demand is of vital importance for overcoming crisis and revitalizing real sector, considering that crisis not only affected finance sector, but it also penetrated insurance sector.

When effects of global crisis are examined, it will be a good approach to divide insurance companies into two groups; "insurance companies insuring financial products" and "traditional insurance companies". When effects are examined within this context, it will be observed that actual effects of crisis are experienced by insurance companies insuring financial products. In our country, products related with insuring financial products are scarce. Reassurance demand in said field is also limited. Accordingly, when sector is considered as a whole, it is anticipated that effects of crisis will be relatively low.

Insurance sector in Turkey had reached a level two times larger than gross national product. Although expectations of authorities relevant to growth in the sector for Year 2009 is about 10-12 percent due to global crisis and political problems, inflation-adjusted real growth expectation has zero or negative values.

Whereas crisis period is regarded by companies with strength financial structure as a period which can be turned into advantage, principal difficulty experienced in such periods is about determining sale price of goods.

Although insurance companies may not experience any challenges in renewing insurance policies, market conditions makes it difficult to purchase new products. Recent data obtained from Association of Reinsurance Companies of Turkey shows that policy sales had increased despite the decrease in premium production. This condition leads companies to pursue a cruel price competition in order not to loose portfolio. At this point, trust felt by the customer and service quality is of vital importance for sustainability of insurance companies.

Whereas Health Insurance business in Turkey was initially assessed in conjunction with other branches such as Life Insurance, branch of Health insurance alone gained importance due to necessity to structure life and retirement insurance as separate fields. Crisis environment unique to our country experienced in 2000 had led to constriction in individual and corporate health insurance sector, however, in following years, an improvement was observed. Contracts entered into by and between social insurance institute, which was put into force within last two years, and hospitals had decreased interest of individuals and corporations to private health insurance. Failure to put supplementary health insurance into force completely is another factor triggering the decrease. Dominating economic environment within year 2008, global crisis is forcing companies to take economizing measures. While a portion of health insurance renewal agreements, usually made at the end of relevant year, could not be performed due to economizing measures, limitations and reductions in indemnities are performed in another part of policies.

Another problem of Turkish Health Insurance business is inability to spread through. Under recent conditions, most of insured individuals and corporations are collected within three metropolitans (İstanbul, Ankara, İzmir). In general, health insurance is rapidly affected from crisis environment due to job loss experienced in metropolitans, as health insurance is mostly preferred by white-collars.

Insurance sector not only has micro-scale functions such as risk management, but it also covers macro-scale functions such as contribution to economic growth by creating funds required for investments and preventing social and economic losses. In developed countries, insurance sector has a considerable share within economy; however, it is not the case for developing countries. Considering membership process to European Union, Turkey should take measures required for establishing an insurance business sector which may integrate into and compete with insurance systems of member states.

In conclusion, health insurance business has potential to develop by implementing marketing methods in a country with population size of almost 70 million. Although crisis may create seasonal effects, gains of individuals from private health insurances are higher than losses. As long as insurance business is spread through the country, prices will decrease considering enlargement in the premium pool and this potential can be turned into a price advantage.

## REFERENCES


AKTAN, C.C. (2004) Economic Crisis, *New Turkey Magazine* (*Yeni Türkiye Dergisi)*, www.canaktan.org

ALKİN, KEREM (2009) Referans Journal, , www.referansgazetesi.com

BOZGEYİK, A. (2008) *Out of the Crisis by Growing*, Beta, İstanbul.

CAN, H. (1997) Organization and Management, Siyasal Press, Ankara.

DİNÇER, Ö. (1998) *Strategic Management and Business Policy*, Beta Press, İstanbul.

ERÇEL, G. (1998) Global economic crisis and Turkey, Deutsche Bank: Emerging Market Conference, Deutsche Bank Seminary, Washington D.C. 3 Ekim 1998, http://www.tcmb.gov.tr/yeni/evds/konusma/tur/1998/k12.html

Alkan, S. (2000). *Insurance Sector*. Türkiye Vakıflar Bankası T.A.O. Sector Research Series/No. 22.

Banker, R. D. A., Charnes, A. and Cooper, W. W. (1984). Some Models for Estimating Technical and Scale Efficiencies in Data Envelopment Analysis, *Management Science*, 30 (9), 1078-1092.

Battese, G. E. and Corra, G. S. (1977). Estimation of a Production Frontier Model: With Application to the Pastoral Zone of Eastern Australia. *Australian Journal of Agricultural Economics*, 21, 3, 169-179.

Berger, A.N. and Humphrey, D.B. (1992). Measurement and Efficiency Issues in Commercial Banking. (Eds.)

Z. Griliches *Output Measurement in the Service Sectors*, University of Chicago Press: Chicago, 245-279.

Charnes, A., Cooper, W. W. and Symonds, G. H. (1958). Cost Horizons and Certainty Equivalents: An Approach to Stochastic Programming of Heating Oil. *Management Science*, 4, No. 3, 235-263.

Charnes, A., and Cooper, W. W. (1959). Chance-Constrained Programming. *Management Science*, 6, 1, 73-79.

Oksay, S. (2004). Effect of Insurance sector on Growth in OECD countries and Turkey. *Traditional Finance Symposium* BSY and BSE Marmara University, 28 May 2004.

Kazgan, H. vd. (1999) *History of Turkish Financial structure from Ottoman to Today.* _stanbul Stock Exchange Market. Creative Yayıncılık: _stanbul.

Data obtained from Association of Insurance and Reinsurance Companies of Turkey

Association of Healthcare Institution Managers, IIIrd National Health Insurance and Contracted Institutions Management Symposium 2009 presentation notes

Williams C. Arthur Jr. and HEINS M, Richard.(1989) Risk Management and Insurance:İndividual Health Insurance Contracts, 24, pp.554-565

Tengilimoğlu, Işık, Akpolat, Healthcare Institutions Management, Ocak 2009, Nobel Press and Distribution, Ankara

Deming, W E (2000) , *Out of Crisis* , MIT Press, Cambridge Mass., US.

SGK, Health-related data of Social Security Institution, www.sgk.gov.tr

Ministry of Health (2007) Health Statistics Annual Datas, Ankara, TR.

National Health Insurance Business and Contractual Institutions Management Symposium Presentation notes (2009), Antalya, TR

TSEV (2008), Turkish Insurance Institute Annual Report, Ankara, TR

The Geneva Association Risk and Insurance Economics and Research, www.geneva association.org

# CHANGES IN ECONOMY POLICIES AFTER GLOBAL FINANCIAL CRISIS AND THEIR EFFECTS ON DEVELOPING COUNTRIES : THE CASE OF TURKEY

**Engin ERDOĞAN**
**Meliha ENER**
**Çanakkale Onsekiz Mart University, Turkey**

## ABSTRACT

*Global economic crisis arising from USA is felt world-wide in a great degree. Turkey is also affected as an developing country and shows a financial impairment from a decrease in domestic demand.Turkey reorganized banking sector and eliminated economic crisis in 2001 by use of IMF programs.In contrast to 2001 Turkısh economic crisis which arised from internal dynamics,recent crisis affects all of the world and needs more complex measures to overcome.*

## INTRODUCTION

IMF programs based on restrıctıon of demand produce similar results among developing countries.Measures such as diminishing the public expenditure,realizing the devaluation and liberalizing the import take place in the standardized procedures of IMF programs.

In this study, IMF programs for developing countries to eliminate the effects of recent global economic crisis were evaluated. General economic effects of global crisis on Turkey and other developing countries were reviewed with their solutions.

## I.GLOBAL CRISIS AND ITS EFFECTS

The crisis that began in September 2008 in USA housing market, increased the uncertainty in world economy and started an unsteadiness in the markets. The crisis that started in the finance markets has taken the reel markets under effect with time. The recession started in developed countries has effected the developing countries which are already in critical levels. While the global development was regressing, the countries were in consensus to take precautions together in strife with the crisis in the world economy.

The world economy, in the last quarter of 2008, has get into recession with a 6 % fall in reel Gross National Product. This recession in world trade and industrial production is the biggest one after the war period.This economical narrowing continues in the first quarter of 2009. The expectations about how long the recession will continue are different. The main idea is it will go on long. It is argued if the healing will be L shaped or V shaped (Mussa, World Recession…, 2009). Turkey is effected from the crisis as many other developing countries had. We will first go through the appearance and enlargement process of the crisis in the world, before we evaluate the effects of the crisis on Turkey.

In 1990 a wellfare period has been lived in the USA economy. This period finished in 2001 with recession. The September 11$^{th}$ had a big influence on making the recession deepen. In this process the reduction of interests, done by FED, become permanent. The recession in interst rates brought vitality to especially housing sector. With the decrease in interest rates in housing loans, many people decided to buy houses. With the expansion in housing loans and directing the credits to lower level people with low solvency brought the risks together. Besides this, selling bonds by showing the housing loans as guarantee and these being used by hedge funds and financial establishments increased the spread of loan risk to finance market (Ünal, Kara, 2009).

The recessiom in interest rates in USA after a while caused an increase in prices. To prevent the inflation rise, FED decided to increase interest rates. This increase brought problems in the turnabout of mortgage loans with changeable interest. House prices started to fall. And in this fall, the least use of housing loans because of the high interests was an affect. The recession appeared in finance market with the increase in house prices,when it come to 2007, stated to cause problems in financial establishments which gave risky housing loans. Some of them go bankrupt. The investors who get worried from this situation has started to change their money into cash. This caused a liqid fund stringency in the markets. In this process, in order to prevent falling into the liqid fund crisis, FED abd European Central Bank raised the liqid fund amount and they offered it to the markets (Ünal, Kara, 2009).

The bankruptcy of a financial establishment which gives mortgage loans started the crisis. The bankruptcy of Lehman Brothers, which is one of the biggest inmvestment bank of USA shows how big is the crisis. This bankruptcy was the sign of the spread crisis to other countries, as all the financial markets are bound together.

The overlook of USA government to the smash of Lehman Brothers, aggravated the degree of the crisis. The bankruptcy of Lehman Brothers effected other financial establishments in USA and EU . Citigroup which is the leading finance esatablishment of USA and AIG the insurance company come to the brink bankruptcy and this shows the depth of crisis. As the crisis started to get deepen, a 700 billion dollars of rescue package come up which is accepted by USA congress. At first this package was only for financial establishments but later it had to cover up precautions aimed at reel sector. The EU countries tried to prevent the bankruptcy of financial establishments, for this they provided funds and even some of them were bought by government. Similar rescue packages were applied in developing countries. Countries like hungary, Iceland, and Ukraine decided to make loan agreements with IMF to reduce the effects of the crisis.

The fears about spread of global crisis from finance sector to reel sector come true after a while. Crisis which started in finance sector and spread to many countries in global process, after a while show its effects on reel sector. Too. The trouble in flow of credit to the reel sector caused regression in production and so many people become unemployed.The increase in the number of unemployed people naturally reduced the total demand and demand to establishments in reel sector which are capable of production.Thus crisis become a neverending cycle; unemployment, lack of total demand, reduction of production, bankruptcy of corporations and again increase in unemployment.... ,and increased the risk. Furthermore, the crisis caused developed and developing countries to narrow their foreign trade and this come up with the risk of reduction in world trade capacity (Demircan, Ener, 2009). The crisis started from finance sector and spread to reel sector effected too many firms, first automotiv sector. With the increase in severance its effect in labor market is seen.

From the point that required arragements to get out of the crisis should be done by all related countries, a meeting done in England in the first half of 2009 by G20 countries, started with the dtermination that the crisis increased to a global dimension. In this sense, the G20 meeting was an important development to show that all the countries should work together to get out of the crisis.

One of the decisions that was made in G20 summit, was forming an institution to control the global finance system, hedge funds and similar risky financial instruments. The request that developing countries were asking for years about bringing a control machanism to finance markets took over with the crisis. International protective commercial restrictions were avoided. Capital movements directed to developing countries will be supported through IMF. In order to reduce the risk of another crisis in the future required arrangements will be done (Bergsten, 2009).

One of the most important decisins taken in G20 summit was planning to allocata a 1 trillion dollars fund to IMF in order to support developing countries. The summit requires more help and support from G20 members ( Johnson, Bone, 2009).

The economical developmentsthat came up since September 2008 effected deeply both developed and developing countries. In this process mostly the packages that countries applied themselves took attention.ltely , the opinion that countries should work together to overcome the nagativeness of the crisis emerged.The decisions taken in G20 summit is a sign of countries' cooperation in the global crisis.The process nad the affects of the crisis is depends on the cooperation of the countries and its continuity.

Otherwise, unemployment will rise, the fall of total demand will speed up, countries will withdraw and international trade will reduce and the crisis will get deepen (Demircan, Ener, 2009).

The world economy is expected to become 2.3 % smaller in the report of IMF's World Economic Outlook. The Global Financial Stability report of IMF states sum of the toxic substances that are a factor in the increase of the crisis, as 4.1 trillion dollars. The 2.7 trillion dollars of this toxic substances are in USA, 1.2 trillion dollars in europa and 150 billion dollars in Japan. On the other hand IMF expects that in 2009 developing countries will need 1.8 trillion dollars finance. It is possible that these countries will feel the effect of the crisis more dense under the case that their finacial needs aren't provided enough. The possibility of the banks in developing countries reducing the fund flow because of the financial problems they live can deepen the crisis in developing countries. It is very important for the developed and developing countries to act together in order to get out of the global crisis that effects both their markets. In G20 summit the importance of this cooperation was stressed and solution proposals were put into words.

One of the most effected groups in developing countries rae East Europa countries, because the funds of West Europa banks in east europa decreases ( Dattels, Kodres, 2009).

According to the two stagflation periods lived after war (1973-76 and 1979-84) the developing countries get the most damage from the global recession. In developing markets, the development is expected to slow down and fall to 5.7 % (Musa, Global Economic…, 2008).

The economical slow down in developing countries, difficulty to reach international loans, the reduction of commodity prices causes an increase to the demand for exportation. (OECD, GDP to Plummet..., 2009) (TABLE 1).

**TABLE 1: PROJECTED REAL GDP GROWTH RATES (percent change, year-over-year)**

| **COUNTRY/REGION** | **2008** | **2009** | **2010** |
|---|---|---|---|
| World | 2.9 | -0.8 | 3.7 |
| Advanced Economies | 0.6 | -2.8 | 3.0 |
| United States | 1.1 | -2.0 | 3.6 |
| Japan | -0.7 | -5.0 | 2.0 |
| United Kingdom | 0.7 | -0.3 | 2.5 |
| Canada | 0.5 | -1.5 | 3.0 |
| Euro Area | 0.7 | -2.5 | 2.5 |
| Germany | 1.0 | -3.0 | 2.9 |
| France | 0.7 | -2.0 | 2.6 |
| Italy | -1.0 | -3.0 | 2.0 |
| Other Euro Area | 0.8 | -2.2 | 2.4 |
| Other Advanced | 0.8 | -4.5 | 3.8 |
| Emerging-Market and Developing | 5.8 | 1.7 | 4.7 |
| Asia | 7.0 | 5.0 | 6.8 |
| China | 9.0 | 7.5 | 8.2 |
| Indai | 7.1 | 5.0 | 6.3 |
| Other Asia | 3.1 | 0.5 | 3.8 |
| Latin America | 4.2 | -1.8 | 3.0 |
| Brazil | 2.8 | -1.3 | 3.2 |
| Mexico | 1.4 | -2.5 | 3.1 |
| Other | 5.1 | -2.0 | 2.8 |
| Central and Eastern Europe | 2.8 | -2.8 | 2.5 |
| Commonwealth of Independent States | 5.4 | -3.2 | 1.5 |
| Middle East | 5.6 | 2.5 | 4.0 |
| Africa | 5.0 | 2.0 | 4.0 |

**Source:** Michael Musa**,** “World Recession and Recovery: A V or an L?”, Fifteenth Semiannual Meeting on Global Economic Prospects, Peterson Institute for International Economics, p.16, April 7 2009.

While contries like Australia, Sweeden, and china continue to strict money politics to lower the inflation, countries like Canada, England slow down the strict money politics to fix their weakened economical development. It is seen that the inflation expectations in Euro by European Central Bank increased over 1%. Because of the reduction of exportation from Japan to USA the development of Japan fall down 1.2% in 2008. The development in industrialized countries it is expected as 1.5% (Musa, Global Economic…, 2009).

## THE REFLECTIONS OF THE CRISIS TO TURKEY

Turkey has done the required banking arrangements after the financial crisis lived in 2001. So, it brought up against the crisis, started in 2008, with the arrangements done in banking. The crisis in 2001 wasn't about the global process but because of turkey's internal dynamics. The 2001 crisis, being restricted only with Turkey, eased to take the required pracautions. However, today's crisis, being global, makes the problem harder. Because, the crisis in this period shows its effect on not only internal dynamics but also external ones.

So, to get over the crisis, Turkey's precautions that it took or will take alone can not bring affective solutions. Besides, it is pleasing that the very first decision taken in G20 summit is the solution of this global crisis must be global. So that, the whole burden of the crisis isnt imputed on developing countries but expected to be solved by the participation of all countries.

The Turkish economy, after resolved the effects of 2001 crisis, brought up against important problems, such as current account deficit and foreign debts. In 2008, before the crisis that started in USA and spread to the world, it was expected that Turkey will bring up against a crisis probably because of the current account deficit. Within this expectation Turkey bring up against the global crisis in 2008.

Before the global crisis started in 2008, intensive foreign money entrance to Turkey- which is one of the countries that short term foreign capital movements prefer- continued. The incrfease in foreign capital that comes with speculative purposes, after a while caused TL become extremely valuable. This slow down the increase in exportation. Against it, because of reducing the import costs it encouraged the demand to import goods. This events in importation and exportation increased the current account deficit of Turkey. With the excessive valuableness in exchange rate, cheapened the costs of foreign loans and it made the private sector loan easily from the foreign markets and this situation caused them a rise in private sector's debts. The continuity of excessive valuablenessin exchange rate policy caused banks to get loans fron foreign finance markets with low costs and distribute it as credits under different names to the domestic market consumer.

With the global economic crisis the cost of borrowing from international markets increased. When the finance market which provides credit to turkey started to be effected from the crisis, borrowing from international markets opportunity restricted. This situation effected the banks in Turkey, but the arrangements done after the 2001 crisis alleviate the probable trouble in banking system. Because of this arrangements, the credits that the banks gave in Turkey weren't directed to the areas with high risks and hard turn backs, like most of the foreign banks and finance establishments did. However, as this credits were taken from international markets and the troubles that this establishments live effected the banking system in Turkey. The banks in Turkey can face with difficulties in renewing the credits they took from abroad. One of the most important effects of the crisis to Turkey will be providing the finance of foreign debts. Because many finance establishments which have the operation capacity in global dimension will not be willing to lend money as before .

The effects of the global economic crisis, after a while, started to be felt in reel sector. This process caused the banks in Turkey start acting abstaining in giving credits to domestic market. The crisis in reel sector, effected many firms especially automotive and textile sectors. The reduction in industrial production, deficiency in total demand, rise of the unemployment increased the risk of banks in giving credits. Many banks started to be selective. This tension appeared in finance system especially in credit level caused many firms that work with small capital nad bank credits, get closed and many people become unemployed. The increase in unemployment narrowed the total demand and this reduced the demand to companies that are less effected from the crisis and caused them to get effected from the crisis. Also the companies that make exportation felt the same thing because of the reduction in total demend world wide. This situation brought recession in automotive and textile exportation which were in good progress lately (Demircan, Ener, 2009).

The current account deficit problem that turkey lives with so long isn't felt as much as before in the crisis period because of the given reasons. After the crisis, because of the recession in the amount of the speculative foreign capital income, the decrease of TL's excessive valuableness and the reduction in total demand, a big fall in importation has a role in this.

The increasein especially dollar rate because of the liqid funds trouble in the world markets, increased the costs of import. This reduced the Turkey's import goods amount. This change in exchange rates increased export with the disappearance of excessively valuable rate. But, as EU countries were effected from the crisis and as they formed the most important group in Turkey's exportation this reduced the increase in turkey's exportation. The trouble felt in textile exportationwas felt in automotive, too. The automotive producers, because of the lack of total demend, couldn't sell their goods. This situation caused unemployement (Demircan, Ener, 2009).

The reduction of consumption in the world after the crisis caused recession in Turkey's exportation. Similar effect appeared in imporatation, too. With the effect of reduction in importation, the countervailing rate of export to import raised lately. This situation narrowed the current account deficit. The reduction in Turkey's export has an effect on sectors that work upon exportation. Because of their sells decreased, the reduction in their production raised severances (TABLE 2).

**TABLE 2: DEMAND, OUTPUT and PRICES in TURKEY**

| | 2005 Current Prices TRL billion | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| | | Percentage Changes, | | Volume (1998 prices) | | |
| **Private Consumption** | 465.4 | 4.6 | 4.1 | 3.2 | 1.1 | 3.9 |
| **Government Consumption** | 76.5 | 8.4 | 6.5 | 4.2 | 2.8 | 2.7 |
| **Gross Fixed Capital Formation** | 136.5 | 13.3 | 5.5 | 3.7 | 2.7 | 6.8 |
| **Final Domestic Demand** | 678.4 | 6.8 | 4.7 | 3.4 | 1.6 | 4.4 |
| **Stockbuilding[1]** | -6.8 | -0.1 | 0.9 | -0.1 | 0.1 | 0.0 |
| **Total Domestic Demand** | 671.6 | 6.7 | 5.5 | 3.4 | 1.7 | 4.4 |
| **Exports of Goods and Services** | 141.8 | 6.6 | 7.3 | 6.0 | 3.8 | 9.4 |
| **Imports of Goods and Services** | 164.5 | 6.9 | 10.7 | 4.4 | 3.6 | 9.0 |
| **Net Exports[1]** | -22.7 | -0.3 | -1.3 | 0.1 | -0.2 | -0.3 |
| **GDP at Market Prices** | 648.9 | 6.9 | 4.6 | 3.3 | 1.6 | 4.2 |
| **GDP Deflator** | - | 9.3 | 7.6 | 12.7 | 9.1 | 8.1 |
| **Consumer Price Index** | - | 9.6 | 8.8 | 10.3 | 8.3 | 7.6 |
| **Private Consumption Deflator** | - | 9.8 | 8.6 | 13.0 | 8.9 | 7.6 |
| **Unemployment Rate** | - | 9.7 | 9.6 | 9.7 | 10.5 | 10.6 |
| **Current Account Balance[2]** | - | -6.0 | -5.8 | -6.7 | -6.1 | -5.7 |

Note: National accounts are based on official chain-linked data. This İntroduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods (http://www.oecd.org/eco/sources-and-methods).

1. Contribution to changes in real GDP (percentage of real GDP in previous yesr), actual amount in the first column.
2. As a percentage of GDP.

**Source**: OECD Economic Outlook , 2009, 84 database, p.135.

One of the effects of the crisis in Turkey is seen at budget equilibrium. With the strict finance policy applied for a while, budget deficits regressed. But because of the effect of the crisis the budget equilibrium started to dteriorate. The interest policies applied for a long time has changed with the effect of the crisis. The high interest policy applied since 1990's to bring short term foreign capital investments has been revised.

Considering the effect of the crisis on total demand, to remove the reduction on total demand, Central Bank went into reduction in interst rates. Some of the precautions taken to reduce the effects of the crisis are; it is aimed to increase the funds that banks could give credit by reducing the deposit additional covers, increasing the amount of the credits given to KOBİ's through KOSGEB is aimed, in order to continue the credit flow providing new credit opportunities to tradesmen and industrialists are aimed. One of the precautions is raising the Eximbank's credits to provide stimulus to import and export. By reducing the premiums that employer'spay to the government, supporting the employers is aimed. To accelerate the industry it is decided to make ÖTC discount in automotive and home appliance sectors for three months.

## CONCLUSION

According to OECD's Economic Outlook Report, the economical deceleration in the world turn into recession in 2009. A fall in OECD countries' Gross National Product is expected. If recession continues for a long time, the rate of unemployment is expected to be 7.2 % 2010, which is 5.65 in 2007. This means a 10.2 million unemployed will be added to the number of the unemployed people in 2007 (Gurria, 2008).

The macro economical policies and structural reforms which are applied since 2001 in Turkey aims to provide macro economic stability and make it permanent. In this process, Turkey's economy developed nearly 6.8% between 2002-2007 (Maliye Bakanlığı, 2008). However, the economical crisis period effected Turkish economy. In World Economic apppearance Report 2008, of IMF turkey's development rate is told 3.5 but it is expected to regress to 3%. The consumer inflation index which raised to 10.5 % in 2008 is expected to regress to 8.4 % in 2009.

To sum up, it is inevitable that the global crisis started in September 2008 effected the finance sector and reel sector. In order to get over the crisis with minimum damage it is necessary to take the required precautions and apply them affectively.

## REFERENCES

Bergsten C. Fred, (2009), Needed: A Global Response to the Global Economic and Financial Crisis, Nonproliferation and Trade, Commitee on Foreign Affairs, Peterson Institute for International Economics, March 12.

Dattels Peter, Kodres Laura, (2009), Further Action Needed to Reinforce Signs of Market Recovery: IMF, IMF Monetary and Capital Department, IMF Survey, April 21.

Demircan Esra, Ener Meliha, (2009), Değişim-İstikrar ve Bütçe Politikaları, Ekin Basın Yayım Dağıtım, Bursa.

Gurria Angel, (2008), The Global Economy and Turkey: An OECD Perspective, Conferance Organised by TÜSİAD, DEIK, İMKB, 15 December 2008, OECD, www.oecd.org.

IMF Global Financial Stability Report, (2009).

IMF World Economic Outlook Report, (2009).

Johnson Simon, Bone Peter, Kwak James, (2009), Baseline Scenario: Post-G-20 Edition, Peterson Institute for International Economics, April 7.

Maliye Bakanlığı (2008), Yıllık Ekonomik Rapor 2008:8.

Musa Michael (2008), Global Economic Prospects: Surviving a Mild Case of Stagflation, the fourteenth semiannual meeting on Global Economic Prospects, September 26.

Musa Michael, (2009), Global Economic Prospects 2008/2009: Hoping for a Global Slowdown and a US Recession, Thirteenth Semiannual Meeting on Global Economics, April 3. Peterson Institute for International Economics.

Musa Michael, (2009), World Recession and Recovery: A V or an L? , Peterson Institute for International Economics, the fifteenth semiannual meeting on Global Economic Prospects, April 7.

OECD Economic Outlook, (2009),84 database, p.135.

OECD, (2009), GDP to Plummet 4.3 Percent Across OECD Countries in 2009 as unemployment Climbs Sharply", Tuesday 31 March, www.oecd.org.

Ünal Ali, Kara Hüseyin, (2009), Küresel Kriz ve Türkiye, Ekonomi ve Politik Araştırmalar Merkezi, İstanbul, Şubat , www.ekopolitik.org.

www.ımf.org

www.oecd.org

# PERFORMANCE MEASURES ALONG THE RELATIONAL CONTINUUM IN A BILATERAL GOVERNANCE STRUCTURE

**Quamrul Islam**
**Kingston Business School, London, UK**

## ABSTRACT

*New organisational forms, including strategic partnerships and networks, are replacing simple market-based transactions and traditional, bureaucratic, hierarchical organisations (Webster, 1992). The shift in the way marketing is being organised is accompanied by both environmental and structural changes (Morgan and Hunt, 1994; Palmer, 2000; Investor Digest, 2001). This new emerging paradigm of thought argues that it is more important to focus on the development and management of relationships than on discrete transactions (Ford, 1980; IMP Group, 1982; Webster, 1992; Grönroos, 1994a, 1994b, 1995, 1997a, 1997b; Berry, 1995).*

*These business-to-business buyer-seller trading interactions have been revealed to take place under a variety of governance structures (Bradach and Eccles, 1989; Heide, 1994), with each one undergoing different stages of development (Dwyer et al., 1987). Despite this overall agreement, existing relationship marketing literature appears silent regarding the deciding factors that determine whether or not a business relationship is continued. More specifically the literature appears to lack any information and normative guidelines as to the relative importance of criteria when assessing the performance of a business relationship (i.e., the relative importance of performance criteria within and between relationship development stages).*

*Consequently, this study examined the bilateral governance structure, business relationship development stages and performance measures in relationship marketing. A conceptual matrix framework was developed with the most representative performance measures in the framework being operationalised. The framework was tested with the aid of self-completion questionnaires in the UK manufacturing sector, the study setting, which has been achieved through a positivist empirical situational study in the form of scenarios.*

*The findings provided an original contribution to academia through an evaluation of the relative importance of performance measures as deciding factors in furthering the development of a business relationship within a bilateral governance structure. For example, there was differential importance of evaluation criteria within and between stages. Within all the stages trust was significant, whilst only commitment and transaction-specific asset investments were significant within the initiation stage; opportunistic behaviour was significant within the monitoring and termination stages; and distance within the initiation and monitoring stages. When moving from the initiation to monitoring stage, commitment and distance were significant. In addition, distance was also significant when moving from the monitoring to termination stages, and when moving from the initiation to termination stages, commitment and opportunistic behaviour were significant.*

*In addition, a contribution has been made to business practice, through the development of normative managerial guidelines to aid decision-making when moving forward or not along the relational continuum under a bilateral governance structure. For example, trust was found to be a significant determinant for all stages of the business relationship and remains constant across all these stages. This implies that suppliers, whether potential or existing, should attempt to demonstrate high levels of trust at all stages of a business relationship. This can be achieved by different actions in different stages of the business relationship.*

# INTRODUCTION

If we could predict the future, then we would maximise our wealth by placing all our money on the most appropriate strategy. Many different strategies are possible in the future, but with the use of scenarios the future can be predicted based on the present conditions (Kahn and Weiner, 1967; Godet, 1982 and 1987). However, many performance measurement systems determine the future based on the past, for example: The results and determinants framework (Fitzgerald *et al*., 1991) measures the performance of service organisations and the European foundation quality model (EFQM, 1997) provides for-profit organisations with a total quality management approach to sharing experience and good practice. Strategic decision-making and performance measurement are important for relationship marketing, where firms are engaged in repeated contract-based transactions of idiosyncratic assets (Morgan and Hunt, 1994).

# LITERATURE REVIEW

The literature reviewed here is diverse bringing together several areas of study. As conceptualised by Dwyer *et al.* (1987) and Palay (1984) relationships evolve and develop through a sequential process of five phases: awareness, exploration, expansion, commitment and dissolution. Whereas Morgan and Hunt (1994) and Berry and Parasuraman (1991) define relationship marketing as the establishment, developing and maintaining of successful relational exchanges, Heide (1994) defines inter-firm governance in terms of an initiation, maintenance and relationship termination processes. Thus the three components of this research are discussed below:

**Buyer-seller relationship stages**: are based on time and, content and process variables, these relationships can then be broken down into a differing number of stages based on: continuous, 3-stage, 4-stage and 5-stage relationship types (Tyler, 1996; Halinen, 1998; Donaldson and O'Toole, 2000).

**Governance**: traditionally has been defined broadly as a mode of organising transactions (Williamson, 1985). A more precise delineation of the concept is offered by Palay (1984), who defines it as a shorthand expression for the institutional framework in which exchanges are: initiated, negotiated, monitored, adapted and terminated (Dwyer *et al*., 1987). Relationships are the most important unit of analysis in order to understand the nature of the business-to-business marketing process (IMP Group, 1982). This view of marketing is based on a totally different philosophy from the marketing mix management approach (Webster, 1992; Brodie *et al*., 1997), the relationship philosophy relies on co-operation and a trusting relationship with customers, stakeholders and other network partners instead of an adversarial approach to customers (Grönroos, 1996).

**Performance Measures and Measurement**: In marketing literature, it is frequently argued that performance measures should be derived from strategy and used to reinforce the importance of strategic variables (Skinner, 1969; Chakravarthy, 1986; Gould and Quinn, 1990; Kaplan and Norton, 2005). Although this does not appear to take place in reality (Neely *et al.,* 1994), there is a link between performance and strategy, and the association between performance measurement and strategy is extensively explored in business strategy literature (Andrews, 1971; Lenz, 1981; Ansoff, 1995; De Toni and Tonchia, 2001).

The need to adopt a balanced range of financial and non-financial performance measures is widely accepted for strategy decision-making (Fiocca, 1982; Eccles, 1991). The gradual acceptance of non-financial performance measures requires a shift in organisational thinking, and a change in strategies, actions and performance measures. This has been deemed cutting the 'Gordian Knot' of misguided performance measurement by Dixon *et al*. (1990). Performance measurement is an important management process (Lusch and Brown, 1996). However, an integrated performance measurement system suitable for evaluating buyer-seller relationships has not yet been developed (Shaw and White, 1999). Companies define success through performance measures and by focusing on internal and external customer's needs. Customers' needs, expectations and requirements help establish organisational objectives and define the performance measures (Manoochehri, 1999). No single measure can cover all these aspects for management.

A structured set of measures and balanced management interpretation was needed as at each stage of the buyer-seller interaction process the relationship needed to be analysed. This required an overall review of performance, to assess progress during the development of the business relationship and identification of key areas for improvement. Evaluation and relationship appraisal are key issues in strategic marketing (Fifield and Gilligan, 1997). Both academics and practitioners regularly research the determinants of success within relationship marketing (Ambler and Kokkinaki, 1997; Hilton, 2002).

The performance of an organisation is measured mainly through human resource, financial and marketing metrics. It is the author's opinion, however, that these metrics have not been effectively used to measure the performance of business-to-business buyer-seller governance structure trading exchanges (Low, 1999; Hilton, 2002) through any of the discussed performance measurement systems. From the literature review it became evident that financial metrics were more important during the initial stages of a business trading exchange. Innovation and end-user thoughts were the most important performance measures during the intervening stage of a 3-stage business exchange, whilst end-user behaviour was the most important performance measures during the final stage of the business trading exchange.

# CONCEPTUAL FRAMEWORK AND RESEARCH HYPOTHESES

Although there is considerable literature there is a paucity of research that attempts to synthesise these three components: stages of the business relationship development, types of governance structures and performance measurement classifications. In order to redress this omission the author has synthesised the extant literature to produce the matrix that forms the conceptual framework of this research and is presented in Figure 1.

There were two main groups of research hypotheses to be tested within a bilateral governance structure. The first group of hypotheses relate to the difference in the relative importance of a performance measure **within** a specific stage of the relationship development process.

**Hypotheses 1: 'Trust', 'Commitment', 'Transaction Specific Asset Investments', 'Opportunistic Behaviour', 'Adaptation', 'Switching Costs' and 'Distance'** are equally important performance measures **within the <initiation – $H_{1a}$> <monitoring – $H_{1b}$> <termination – $H_{1c}$>** stage of the relationship development process, when deciding **whether to continue or terminate** a business exchange.

The second group of hypotheses relates to the difference in the relative importance of a performance measure **between** successive stages of the relationship development process.

**Hypotheses 2: 'Trust', 'Commitment', 'Transaction Specific Asset Investments', 'Opportunistic Behaviour', 'Adaptation', 'Switching Costs' and 'Distance'** are equally important performance measures **when moving between the <initiation and monitoring – $H_{2a}$> <monitoring and termination – $H_{2b}$> <initiation through the monitoring and into the termination – $H_{2c}$> stages** of the relationship development process.

The performance of each performance measure represents the independent variable, while the decision as to whether to continue or terminate a business relationship at the end of the initiation, monitoring and termination stages are the dependent variables.

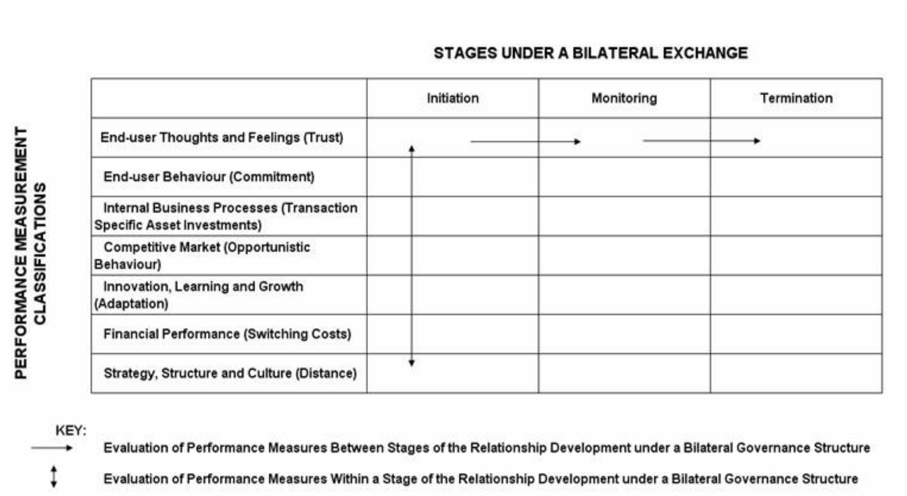



Figure 1: Conceptual Matrix Framework of Performance Measurement Classifications during the Business Relationship Development Process under a Bilateral Governance Structure

# METHODOLOGY

The researcher views that the performance of business-to-business trading exchanges can be measured and has thus measured the outcome. The hypotheses were tested using scenarios in a contrived cross-sectional study of furniture manufacturers in the UK. A mail survey was employed as the primary data collection method with the aid of the Internet as another source. A total of 3,000 questionnaires were delivered to UK furniture manufacturers using a six-step sampling process (Dillman, 1978 and 1983). A variety of inducements were used to improve response rates and, from the scenarios that had been created, a hypothetico-deductive positivist approach was followed to empirically test the research hypotheses (Warburton, 2000; Sekaran, 2003). In addition the findings of the study sample were induced in order to be able to generalise to the wider population.

Overall a low response rate of 9.6% was obtained and the researcher was unable to elucidate the reasons for the low response rate. As the response rate was 9.6% partial least squares (PLS) and bootstrapping were the main statistical techniques used. These data analysis techniques could be used with smaller sample sizes (Chin, 1998; Chin and Newsted, 1999).

**Data analysis**: comprised assessment/analysis of measurement accuracy, reliability, validity and evaluation of the proposed model. The researcher evaluated the relative importance between performance measures during business exchanges along the different stages of the business relationship development process under the bilateral governance structure using Partial Least Squares.

**Evaluation of proposed model**: As the intention was to test the relative importance of seven independent variables (performance measures) to three non-metric dependent variables (decision to continue or not along stages of business relationship development) PLS was the main analytical technique. The statistical package for PLS was the software used as bootstrapping enabled the small sample size to be re-sampled to a larger sample size and Jack-knifing enabled cross-validation. Hence, the researcher empirically tested the conceptual framework in order to make generalisations on the wider population (Pallant, 2005).

# RESULTS

**First set of hypotheses** *evaluated the relative importance of performance measures as deciding factors in the development of business relationships within the different stages of a bilateral governance structure*: The relative importance of performance measures within stages of the relational continuum were evaluated using a scenario approach. Scenarios were constructed in which respondents were asked to assess the relative importance of performance measures within stages of the relational continuum under a bilateral governance structure. Using whether the relationship was continued or not as the dependent variable the impact/significance of each performance measure was assessed using PLS, separate analysis was carried out for each of the three stages. In addition, $R^2$ was satisfactory within all three stages, with the model accounting for greater than 75% of the variance of the dependent variable for each stage (initiation stage, $R^2 = 0.790$; monitoring stage, $R^2 = 0.768$; termination stage, $R^2 = 0.841$). From the results and relating to the hypotheses it can be concluded that:

**Second set of hypotheses** *evaluated the relative importance of performance measures as deciding factors in the development of business relationships in progressing from one stage to the next within a bilateral governance structure:* The relative importance of performance measures between stages of the relational continuum were evaluated in order to assess whether or not there were trends in the relative importance of performance measures between stages of the relational continuum under a bilateral governance structure. This was done by comparing the pathway coefficients of each of the independent constructs on whether a relationship was continued or not between the three stages.

# CONTRIBUTION OF RESEARCH TO ACADEMIA AND MANAGEMENT

Despite an extensive review of extant literature the author has not been able to identity either conceptual or empirical research that has attempted to combine the above three components. More specifically, the literature does not offer any indication as to the relative importance of performance criteria within and between stages of the interaction process under different governance structures. The identified gap in the extant literature has shown it will be useful to have normative guidelines for practitioners when evaluating performance measures along the relational continuum (Investor Digest, 2001). Nohria *et al*., (2003) in their 4+2 formula have offered guidelines to form a successful organisation, but have not explicitly given guidelines for measuring the performance of relationships. Consequently the research proposed here aims to redress this omission in the extant literature and offer managers normative guidelines that could help in their decision-making process.

**Theoretical Contributions**: From a theoretical standpoint the findings presented here provided considerable support to the extant literature. This is the first study that has evaluated the importance of the seven performance measures (trust, commitment, transaction specific asset investments, opportunistic behaviour, adaptation, switching costs and distance) as deciding factors across the three stages of a relationship (initiation, monitoring and termination) under a bilateral governance structure, more specifically:

**Managerial Contributions***:* A firm needs to consider the important determinants during the decision to continue or not with a relationship, but as yet the literature has not provided normative guidelines to buyers on how this would be achieved (Porter, 1985; Perlmutter and Heenan; 1986).

As such, this author believes that the major managerial contribution of this research was the provision of a set of clearly defined, prescriptive guidelines that buying practitioners can use when evaluating the relative importance of performance measures as determinants during movements along the relational continuum, when deciding to continue or not with the relationship. These guidelines are empirically derived and reflect good practice, which is regarded as a strong differentiation of this research from all the studies debated. From a managerial standpoint the findings presented here provided considerable support to the normative guidelines.

# CONCLUSIONS

Other dimensions could be added to the social process between two organisations, apart from behaviours and attitudes, for example ethics, religion, strategic orientation, executive values, environmental and industry characteristics. Relationship formation is a dynamic and processional phenomenon where many factors play important roles and it is very difficult to separate and represent the key critical performance measures in order to build a theoretical/conceptual model at the necessary level of parsimony. Adding more performance measures to the model, as well as more stages (Dwyer *et al*., 1987) and evaluating the market, unilateral and network governance structures (Heide, 1994; Bradach and Eccles, 1989) would develop this research further and provide additional insights. However, in this study seven dimensions of performance measurements have been used, but this limited number represents the wider constructs and can be generalised. Nevertheless, the seven performance measurement dimensions are extensive and cover all the main areas involved in decision-making by managers during a business trading exchange.

Industry mindsets are potentially a valuable field for similar empirical inquiry in relationship marketing in the business environment, an understanding of the core set of assumptions should certainly allow insight into an industry's perception of its environment, internal interpersonal relationships, intra-industry structures and processes, if knowledge is shared at this level of analysis. In addition, it should provide academic organisation researchers and practitioners with a basis from which to interpret and anticipate characteristics of cross-industry interactions. Thus, activities that potentially pose cultural issues e.g., mergers, acquisitions, joint ventures, managing conglomerate organisations, communicating with or assimilating employees from other industries could be facilitated (Webster, 1992).

# REFERENCES


Ambler, T. and Kokkinaki, F., (1997), 'Measures of Marketing Success'. *Journal of Marketing Management,* Vol. 13, Issue 7, pp. 665-678.

Andrews, K. R., (1971), *The Concept of Corporate Strategy*. Homewood, IL: Dow Jones-Irwin.

Ansoff, H. I., (1995), 'Performance Control Corporate Strategy'. In: Kock, R. (Editor), *The Financial Times Guide to Strategy*, London: Pitman Publishing.

Berry, L. L., (1995), 'Relationship Marketing of Services - Growing Interest, Emerging Perspectives'. *Journal of the Academy of Marketing Science,* Vol. 23, No. 4, pp. 236-246.

Berry, L. L. and Parasuraman, A., (1991), *Marketing Services*. New York: The Free Press.

Bradach, J. L. and Eccles, R. G., (1989), 'Price, Authority and Trust: From Ideal Types to Plural Forms'. *Annual Review of Sociology,* Vol. 15, Issue 1, pp. 97-118.

Brodie, R. J., Coviello, N. E., Brokes, R. W. and Little, V., (1997), 'Towards a Paradigm Shift? An Examination of Contemporary Marketing Practices'. *Journal of Marketing Management,* Vol. 13, Issue 5, pp. 383-406.

Chakravarthy, B. S., (1986), 'Measuring Strategic Performance'. *Strategic Management Journal,* Vol. 7, Issue 5, pp. 437-459.

Chin, W. W., (1998), 'The Partial Least Squares approach to structural equation modelling'. In: Marcoulides, G. A. (Editor), *Modern Methods for Business Research*', Mahwah, NJ: Lawrence Erlbaum Associated, pp. 295–336.

Chin, W. W. and Newsted, P. R., (1999), 'Structural Equation Modeling Analysis With Small Samples Using Partial Least Squares'. In Rick Hoyle (Editor), *Statistical Strategies for Small Sample Research*, New York: Sage Publications, pp. 307-341.

De Toni, A. and Tonchia, S., (2001), 'Performance Measurement Systems - Models, Characteristics and Measures'. *International Journal of Operations & Production Management,* Vol. 21, Issue 1/2, pp. 46-63.

Dillman, D. A., (1978), *Mail and Telephone Surveys: The Total Design Method*. New York: John Wiley and Sons.

Dillman, D. A., (1983), Mail and other Self-administrated Questionnaires, In: Rossi, P. H., Wright, J. D. and Anderson, A. B., (eds), *Handbook of Survey Research*, New York: Academic Press.

Dixon, J. R., Nanni, A. J. and Vollmann, T. E., (1990), *'The New Performance Challenge - Measuring Operations for World-Class Competition'*. Homewood, IL: Dow Jones-Irwin.

Donaldson, B. and O'Toole, T., (2000), 'Classifying Relationship Structures: Relationship Strength in Industrial Markets'. *Journal of Business & Industrial Marketing,* Vol. 15, Issue 7, pp. 491-506.

Dwyer, F. R., Schurr, P. H. and Oh, S., (1987), 'Developing Buyer-Seller Relationships'. *Journal of Marketing,* Vol. 51, Issue 2, pp. 11-27.

Eccles, R. G., (1991), 'The Performance Measurement Manifesto'. *Harvard Business Review,* Vol. 69, Issue 1, pp. 131-137.

EFQM, (1997), *Self-Assessment Guidelines for Companies.* The Netherlands: Pabo Print BV.

Fifield, P. and Gilligan, C., (1997), *Strategic Marketing Management 1997-1998: Planning and Control, Analysis and Decision*. Oxford: Butterworth-Heinemann.

Fiocca, R., (1982), 'Account Portfolio Analysis for Strategy Development'. *Industrial Marketing Management,* Vol. 11, Issue 1, pp. 53-62.

Fitzgerald, L., Johnston, R., Brignall, S., Silvestro, R. and Voss, C., (1991), *Performance Measurement in Service Business*. London: CIMA.

Ford, D., (1980), 'The Development of Buyer-Seller Relationships in Industrials Markets'. *European Journal of Marketing,* Vol. 14, Issue 5/6, pp. 339-354.

Godet, M., (1982), 'From forecasting to 'La Prospective': A new way of looking at futures'. *Journal of Forecasting,* Vol. 1, Issue 3, pp. 293-301.

Godet, M., (1987), *Scenarios and Strategic Management*. London: Butterworths Scientific.

Grönroos, C., (1994a), 'From Marketing Mix to Relationship Marketing Towards a Paradigm Shift in Marketing'. *Management Decision,* Vol. 32, Issue 2, pp. 4-21.

Grönroos, C., (1994b), 'Quo Vadis, Marketing? Toward a Relationship Marketing Paradigm'. *Journal of Marketing Management,* Vol. 10, Issue 5, pp. 347-360.

Grönroos, C., (1995), 'Relationship Marketing: The Strategy Continuum'. *Journal of the Academy of Marketing Science,* Vol. 23, No. 4, pp. 252-255.

Grönroos, C., (1996), 'Relationship marketing: strategic and tactical implications'. *Management Decision,* Vol. 34, Issue 3, pp. 5-14.

Grönroos, C., (1997a), 'Keynote paper From marketing mix to relationship marketing - towards a paradigm shift in marketing'. *Management Decision,* Vol. 35, Issue 4, pp. 322-340.

Grönroos, C., (1997b), 'Value-Driven Relational Marketing: from Products to Resources and Competencies'. *Journal of Marketing Management,* Vol. 13, Issue 5, pp. 407-419.

Halinen, A., (1998), 'Time and Temporality in Research Design: A Review of Buyer-Seller Relationship Models' In: P. Naude and P. W. Turnbull (Editors) *Network Dynamics in International Marketing,* Oxford: Elsevier Science, pp.112-139.

Heide, J. B., (1994), 'Interorganisational Governance in Marketing Channels'. *Journal of Marketing,* Vol. 58, Issue 1, pp. 71-85.

Hilton, A., (2002), 'In the Nature of the Beast'. *Securities and Investment Review*, No. 96, p. 9.

IMP Group, (1982), 'An Interaction Approach', in *International Marketing and Purchasing of Industrial Goods*. Chichester, UK: John Wiley and Sons.

Investor Digest (2001), 'B2B Poised for Strong Growth'. *Investor Digest,* Feb 16.

Kahn, H. and Weiner, A., (1967), *The Year 2000*. New York: MacMillan.

Kaplan, R. S. and Norton, D. P., (2005), 'The Balanced Scorecard: Measures That Drive Performance'. *Harvard Business Review,* Vol. 83, Issue 7/8, pp. 172-179.

Lenz, R. T., (1981), 'Determinants of Organisational Performance: An Interdisciplinary Review'. *Strategic Management Journal,* Vol. 2, Issue 2, pp. 131-155.

Low, J., (1999), 'Gauging Results: What Measures Matter?'. *Harvard Management Update,* Vol. 4, Issue 1, p.10.

Lusch, R. F. and Brown, J. R., (1996), 'Interdependency, Contracting and Relational Behaviour in Marketing Channels'. *Journal of Marketing,* Vol. 60, Issue 4, pp. 18-38.

Manoochehri, G., (1999), 'Overcoming obstacles to developing effective performance measures'. *Work Study,* Vol. 48, No. 6, pp. 223-229.

Morgan, R. M. and Hunt, S.,D., (1994), 'The Commitment-Trust Theory of Relationship Marketing'. *Journal of Marketing,* Vol. 58, Issue 3, pp. 20-38.

Neely, A. D., Mills, J. F., Platts, K. W., Gregory, M. J. and Richards, A. H., (1994), 'Realising Strategy through Measurement'. *International Journal of Operations & Production Management,* Vol. 14, No. 3, pp. 140-152.

Nohria, N., Joyce, W. and Roberson, B. (2003), What Really Works. *Harvard Business Review* Vol. 81, Issue 7, pp. 42-52.

Palay, T. M., (1984), 'Comparative Institutional Economics: The Governance of Rail Freight Contracting'. *Journal of Legal Studies,* Vol. 13, Issue 2, pp. 265-288.

Pallant, J., (2005), *SPSS Survival Manual: A step-by-step Guide to Data Analysis Using SPSS Version 12*. 2nd Edition, Maidenhead, UK: McGraw-Hill.

Palmer, A., (2000), 'Co-operation and Competition: A Darwinian Synthesis of Relationship Marketing'. *European Journal of Marketing,* Vol. 34, Issue 5/6, pp. 687-705.

Perlmutter, H. V. and Heenan, D., (1986), Cooperate to Compete Globally. *Harvard Business Review,* Vol. 64, Issue 2, pp. 136-142.

Porter, M. E., (1985), *Competitive Advantage*. New York: The Free Press.

Sekaran, U., (2003), *'Research Methods for Business Students: A Skill Building Approach'*. 4th Edition, New York: John Wiley and Sons.

Shaw, R. and White, C., (1999), 'Improving Marketing Accountability through Better Management of the Market Research Process'. *Journal of Marketing Management,* Vol. 15, Issue 8, pp. 857-880.

Skinner, W., (1969), 'Manufacturing - missing link in corporate strategy'. *Harvard Business Review,* Vol. 47, Issue 3, pp. 136-145.

Tyler, K., (1996), 'Exchange relationships in financial services: marketing equities to institutions'. *International Journal of Bank Marketing,* Vol. 14, Issue 2, pp. 50-63.

Warburton, N., (2000), *Philosophy: The Basics*, 3rd Edition, Routledge: London.

Webster, F. E. Jr., (1992), 'The Changing Role of Marketing in the Corporation'. *Journal of Marketing,* Vol. 56, Issue 4, pp. 1-17.

Williamson, O. E., (1985), *The Economic Institutions of Capitalism*. New York: The Free Press.

# THE FORMS OF THE EU GOVERNANCE AND CONSTRUCTION OF THE EU BORDERS

**Filiz Coban**
**Canakkale Onsekiz Mart University, Turkey**

## ABSTRACT

*This paper critically examines the effects of European integration on borders. In order to do this, the paper is divided into four main parts: the first one provides a brief overview of Europe's borders before the EU with the focus on history and past; the second one gives a summary of the evolution of integration, European citizenship and Schengen; third one presents the concrete findings of how the discourse of the EU Governance contributes to the construction of EU borders. I conclude with a summary of the findings.*

***Key Words:*** *EU governance, Schengen, borders, EU citizinship*

## INTRODUCTION

Today, Europe is witnessing a process of deep transformation and redefinition of the old concept of integration. The debate about the enlargement of the EU towards Eastern countries is creating a question of Europe's eastern frontier shows physical geography is a science as any (Hoffman 1961). Is Turkey part of Europe? Or of Asia? What about Russia? They are Europeans anyway and sooner or later they will join the Union. If there are not Europeans, is there a common European culture and identity? Or is Europe a land of differences, diversity and even divisiveness? (Berezin, Schain 2003: 35) Identity will imply a new politization of integration project. In these process is the model to be assimilation, integration or multiculturalism for European enlargement?

The political strategy will lead to the success of the future enlargements of the EU. Strategic thinking and planning of the EU's future also mean taking decisions on shaping and reconstructing the Union's borders. To understand what is happening in the EU, what is been achieving or failing, strength, weakness, opportunity and threat analysis (Guclu 2003, Dincer 1998) must be made in existing circumstances. To create and have own future the EU governance will manage the integration process in the contexts of vision, mission, planning, action and control (Aktan 1997, Duren 2000). The paper shows that strategic management approach (objectives, strategy, organizational structual, control) can be applied usefully to highlight the integration problems of the EU.

By comparing attempts to mainstream EU citizinship and border policy this study provides new insights into current developments in both policy fields as well as highlight the underlying strengths and weakness of the mainstreaming strategy, management and new forms of EU governance in general.

## THE BORDERS OF EUROPE BEFORE THE EU

In every age there are geo-political situtations which heavly influence the mental maps of writers, politiciens and others. As Peter Burke has written, 'Europe is not so much a place as an idea.' The unity of Europe is a mental construct, and its identity a collective social fabrication over time (Wintle 1996 :52). For example, Europa of the Agient Age, Frankish Christian Europe of the Charlemagne (was called King of Europe), the Enlightenment concept of Europe, Europes' of Napoleon's regime or Hitler's regime have different senses of the continent. The visual and perceived representation of Europe's borders are based on the cultural and political statements, even to give it a georaphical identity.

Europe's image has constantly changed, and is still changing, all in the mind and reality. Ideas about European unity are old (Hoggart&Johnson 1988), although the integration process of the European states was initiated after, and under the impression of, the Second World War (Judt 2005, Larat 2005). The European integration project was designed in the early 50s as a response to the 'dark continent's past'(Mazover 1998) : the heritage of imperialism, nationalism and dictatorship, genocide, ecocide and two great wars. Historical conflicts both between European nation states and within European societies are present in all important areas affected by the integration.

## EUROPEAN INTEGRATION

The European Union is open to all European states that share its goals of freedom, democracy and prosperity, are able to take on the economic challenges of membership and to implement its rules. Immediately after the collapse of communism around 1990, the European Union supported the democratisation process in the former communist countries. On 1 January 1995 Austria, Finland and Sweden acceded to the EU. 8 of these countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia), plus the Mediterranean islands of Malta and Cyprus, joined on 1 May 2004. Romania and Bulgaria who were deemed unready by the Commission to join in 2004, took place on 1 January 2007.

These enlargements will change the way the Union is run as the newcomers take their places alongside existing member states (27 members) in the EU's key institutions. Enlargement on this scale will also bring about changes in its external relations, particularly with the countries to the east and south who are its new neighbours.

European integration project has to overcome difficulties. On a political level, some asked whether such a big enlargement might slow European integration or dilute current achievements. The experience of previous EU enlargements has shown that old and new integrate smoothly and that short-term strains are soon offset by long-term gains (EC 2003: 12). Moreover, enlargement in itself will create further economic growth and prosperity, and will thus sustain the positive trends.

It is already clear that the European integration project has become more than just an economic project and is therefore in need of a new legitimation (Hix 2003). Similarly, the admittance of new member states is not simply about the financial and technical difficulties of adopting of the existing union. It is necessary to underline the importance of 'identity' point after enlargement. A European concept of citizenship which seeks to achieve a deepened integration through some form of intentional 'identity politics' would then be fundamentally misconceived. How to cope with cultural diversity and divergent historical memories seem to be the challenge that Europe is facing (Leontidou 1994).

The newcomers have a particularly important part to play in protecting EU citizens' rights to free movement and personal security. Internal mobility and security within the EU is ensured in part by effective controls at the Union's external frontiers. Because of their geographic position, newcomers are taking over responsibility for controlling large stretches of these borders. Efforts are in hand to reinforce border controls- against illegal immigration, or criminals, from outside - by new members along the Union's new eastern frontier. Internal frontiers between the newcomers and other Union members will only be removed once external frontier protection is deemed to be adequate, based on a unanimous decision of the member states.

### the Construction of EU Borders

Borders are multidimensional. This study views borders as social constructions created through the inter-actions of numerous participants in a variety of sites (Barth 1969, Walmann 1978). More specifically, this paper distinguishes between territorial and identity borders (the former delineating divisions marked on the surface of the Earth, while the latter are marking separations between groups of people made on the grounds of their various characteristics).

the Commission is the executive organ of the Union which have responsibilities as being those of initiative, implementation and supervision (Leonard 2005: 49), therefore, in order to examine the construction of EU borders, this study interrogates a variety of Commission documents on the Policy area in question. the Commission is as a driving force for the abolition of existing borders and can have three major effects – it can abolish previously existing borders; it can construct a new border at the outer edges of the EU and it can re-construct internal EU borders (Kostadinova 2008).

## Schengen Borders

In 1985 France, Germany, the Netherlands, Belgium and Luxembourg decided to create a territory without internal borders which is known as the Schengen Area. This integration system of the border management proceses expanded to include 13 countries, following the signing of the Treaty of Amsterdam. The Schengen regime is characterised by common rules regarding visas, asylum rights and checks at external borders ( Furness 2000).

July 1994 the European Commision established the first cross-border cooperation programme (under the Phare Programme) and pursued similar aims, in particular economic development in the border regions of central and eastern European countries and greater convergence of their level of development with that of the European Union. It extends the programme's geographical scope and improves the way it works by increasing the number of projects of a typically cross-border nature and stepping up the pace of implementation. The programme must be conducted in coordination with the Community's structural policies and the Interreg programme (http://europa.eu/scadplus/leg/en/lvb/g24204.htm). This programme encourages harmonious and balanced development of the European territory Interreg I (1991-1993), Interreg II (1994-1999), Interreg III (2000-2006) aims to develop of cross-border cooperation, and to help the regions on the EU's internal and external borders overcome the problems resulting from their isolation.

From 1 January 2007 Integred programme was replaced by the Instrument for Pre-Accession Assistance (IPA), which is a single financial framework for candidate countries (and for the potential candidate countries of the Western Balkans) for the period 2007-2013. Actions eligible for funding under the cross-border cooperation programme include:

- alleviation of the administrative and institutional obstacles to the free flow of persons, products or services across borders;
- improvement of infrastructures and the provision of local water, gas and electricity supplies;
- environmental protection;
- agricultural and rural development;
- measures in the fields of energy and transport aimed at the development of trans-European networks;
- justice and home affairs;
- promotion of business cooperation, enterprise development, financial cooperation and cooperation between institutions representing the business and industrial sector;
- aid to investment and provision of supporting services and facilities;
- training and employment measures;
- local economic development;
- measures to promote cooperation in health;
- the development and establishment of facilities and resources to improve the flow of information and communications between border regions;
- cultural exchanges;
- local employment, education and training initiatives

Transnational cooperation between national, regional and local authorities aims to promote a higher degree of territorial integration, with a view to achieving sustainable, development in the Community and better territorial integration with candidate and other neighbouring countries by developing cross-border economic and social networks.

In the post-9/11 world managing borders is a complex and challenging task, also more anxious than ever to ensure that frontiers are secured against external threats (http://www.dur.ac.uk/ibru/themes/). The EU is developing a border management strategy that aims at an integrated and global response to the challenges emerging from threats and irregular immigration though the common eternal borders. On November 2006 The European Council agreed on a definition of what 'Integrated Border Management' (IBM) means in the EU (Carrera 2007) . IBM means the organization and supervision of border agency activities to meet the common challenge the facilitating the movement of legitimate people and goods while maintaing secure borders and meeting national legal requirements (GFP 2005). On 26th October 2006 the EU Council establish the European Agency for the Management of Operational Cooperation at the External Borders of Member States of European Union (FRONTEX) for strengthening security at the EU's external borders. Frontex tasks (Fernandez 2008 :125):

- Coordination of operational cooperation between Member States in the field of management of external borders;
- Assistance to Member States in the training of national border guards, including the establishment of common training standards;
- Carrying out risk analyses;
- Following up the development of research relevant for the control and surveillance of external borders;
- Assistance to Member States in circumstances requiring increased technical and operational assistance at external borders;
- Providing Member States with the necessary support in organising joint return operations.

One of the key elements of the EU strategy to secure external borders was the creation of the body and FRONTEX is a key player in the implementation of common EU policy for that. (http://www.frontex.europa.eu/more_about_f rontex/)

In addition to this, a framework programme on Solidarity and Management of Migration Flows for the period of 2007-2013 has key importance to strengthen the EU as an area of freedom, security and justice. The Commission's new financial framework includes European Refugee Fund, External Borders Fund, European Fund For Integration and European Return Fund. (http://eur-lex.europa.eu/LexUriServ/site /en/com /2005/com2005_0123en01.pdf)

### The Forms of the EU Governance

Since the mid-1990s, the EU has been experimenting with a variety of new forms of EU governance, including memory politics in contested political issues, open methods of coordination&civil dialogue and the construction of borders (Stan 2006). There are three main periods in the evolution of co-operation on border controls. The first is from 1985 (when the Schengen Agreement was signed) to 1992 when the Treaty of the EU was signed. The second period is between 1992 and 1997. The Single European Act established Internal EC Market by 1992 and the Amsterdam Treaty was adopted in 1997, bringing the Protocol on Social Policy and the Schengen Agreement into the EC framework. The third one is from 1997 to present.

From 'economic Europe' to 'social Europe' the establisment of EU citizinship under the Treaty of EU aims to create an area without internal borders. These also include a transformation to a 'political Europe' that has a common foreign and security policy and cooperation over judical, police and immigration issues.

A political Europe, a social Europe and an economic Europe are as the forms of EU Governance provide three different definitions of Europe's borders and the three forms of 'European citizenship': first, the European 'market citizen' (Hans Peter Ipsen) who enjoys private autonomy in the great European economic space; second, the active citizen that is particularly sensitive whenever 'Europe' touches upon matters related to identity (Jarausch 2005), in this respect, it is possible to speak of Europeanised identity (Grimm 2005); third, the un-Europeanised political citizen of EU who exercises his political autonomy under the umbrella of a constitutional state (Habermas 1990, 2003).

## CONCLUSION

Objectives determine strategy, strategies determine structure and structure determines control in a State or an Union of States as the EU (Ashta, Ernult 2004). Strategic decisions lead to a restructuring of the organizations in the changing circumstances. In this strategic management approach to the study of EU's borders policy, it is considered to take into account the appropriateness of the possible visions of the EU Governance.

As Will Hutten observes (cited in O'dowd 2001: 67): *all borders are coming down. There is a new conception of time, risk and oppurtiny,* Europe today is becoming 'Europe without borders', but the question of 'for who and how this Europe is being constructed' is vital for future goals of the Union. Different forms of the EU Governance contitute the different forms of membership and citizinship. Borders are not merely economic barriers, they are simultaneously administrative, legal, political, cultural and even psychological barriers. All in all, European enlargement and reconstruction of the Europe's borders are related to identity and citizinship, rather than physical borders. In order to determine how the EU will maintain being as a global power , decision makers of the Union determine what is included and excluded inside and outside these borders. As a result of that, which form is chosed as a model of citizinship for People of the Union may be able to determine the future of Europe.

# REFERENCES


C. C. Aktan, *Degisim ve Yeni Global Yonetim*, (1997), İstanbul Mess Yayinlari

F. Barth, *Ethnic Groups and Boundaries: The social organisation of culture diffrence*, (1969), London: George Allen an Unwin

M. Berezin& M.Schain, *Europe Without Borders*, (2004), Maryland, the John Hopkins University Press

E. Berglund, *Protection of EU Borders*, FRONTEX, Head of Research and Development Unit, 5 October 2007

S. Carrera, *The EU Border Managment Strategy*, CEPS Working Document No.261 March 2007

*Citizenship of the Union in the Maastricht Treaty*, pp. 5-6, available at http://www. Eurotreaties.com/ maastrichtec.pdf, visited on 28.07.2008

Communication from the Commission on the *'Wider Europe- Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours*', 11 March 2003 at http://europa .eu.int/comm/external_relations/we/doc/com 03_104_en.pdf (last accessed 3 September 2007).

O. Dincer, *Stratejik Yonetim ve Isletme Politikasi*, (1998), Istanbul Timas Matbaa

Z. Duren, *2000'li Yillarda Yonetim*, (2000) Istanbul, Alfa Yayinlari

P. Drucker ,21. Yüzyıl Icin Yonetim Tartismalari, (1999 ), Istanbul, Epsilon Yayincilik

European Commission, *"Proposal for a regulation determining the Third Countries whose Nationals must be in possession of a visa when crossing the external borders of the Member States"*, COM (93) 684 final, 10.12.1993, p. 35

European Commission, 'Proposal for a Council Directive relating to the conditions in which third-country nationals shall have the freedom to travel in the territory of the Member States for periods not exceeding three months, introducing a specific travel authorization and determining the conditions of entry and movement for periods not exceeding six months', COM (2001) 388 final, 10.07.2001, p. 5

N. Guclu, *Stratejik Management*, (2003), Ankara, G.Ü. Gazi Egitim Fakultesi Dergisi, Cilt 23, Sayi 2 61-85

D. Grimm, '*Integration by constitution*', 3 (2005) International Journal of Constitutional Law, 193-208.

S. Forness, *Brave New Borderless State*, IBRU Boundary and Security Bulletin, Autumn 2000

J. Habermas, *'On the Public Use of History'*, in: *ibid., The New Conservatism*, (1990), Cambridge MA: MIT Press, 233.

J. Habermas, *'February 15, or What binds Europeans Together: a Plea for a Common Foreign Policy, beginning in the Core of Europe'*, (2003) 10 *Constellations*, 291-97, at 296.

S. Hix, *The End of Democracy in Europe?,* (2003), Department of Government , LSE

G.W. Hoffman, *A Geography of Europe*, (1961), Newyork, the Ronald Press Company

R. Hoggart ve D. Johnson, *Ideas about an 'Idea of Europe'***,** Joyce, Christopher(ed.), Questions of Identity**.** (1988), London: New European Publications

J. Hughes, G. Sasse, C. Gordon, *Saying 'Maybe' to the 'Return to Europe': elites and the political space for euroscepticism in Central and Eastern Europe.* In: „European Union Politics", Vol. 3(3), 2002, pp. 327-355.

*Integrated Border Management*, The United Nations Trade Facilation Network, Global Facilatation Partnership for Transpotation and Trade, June 2005

K.H. Jarausch, *'A European Cultural Identity: Reality or Hope?'*,( 2004), Typescript Potsdam

T. Judt, *Postwar. A History of Europe since 1945*, (2005), New York: Penguin, , at 803-831

F. Larat, '*Present-ing the Past: Political Narratives on European History and the Justification of EU Integration*', (2005) 6:2 *GLJ.*

L. Leontidou, *The Boundaries of Europe Deconstructing Three Regional Narratives. Identitiees* Oct-Nov. : Vol. 11 Issue 4, 1994

V. Kostadinova, The European Commission, Schengen and Construction of EU Borders, (2008), http://www.uaces.org/pdf/papers/0801/2008_Kostadinova.doc

M. Mazower, *Dark Continent. Europe's Twentieth Century*, (1998), London: Penguin.

L. O'dowd, *Analysing Europe's Borders*, IBRU Boundary and Security Bulletin, Summer 2001

D. Phinnemore, (2004), *The Treaty establishing a constitution for Europe: An Overview,* Royal institute of International Affairs, June 2004, EP BN 04-01v2

Peter W. Preston, *Reading the Ongoing Changes: European Identity***,** Oxford: The Political Quarterly Publishing Co.Ltd, 2005

Anthony D. Smith, *The Nation: Invented, Imagined, Reconstructred?*, RINGROSE, Marjorie(ed.), A. J. LERNER(ed.), Reimagining the Nation, Buckingham: Open University Pres, 1993

L. Stan, *The vanishing truth? Politics and memory in post-communist Europe.* In: "East European Quarterly", Vol. XL, No. 4, December 2006, p. 387

The Treaty Establishing the European Economic Community, p. 51, available at http://www.unizar.es euroconstitucion/library/historic%20documents/Rome/TRAITES_1957_CEE.pdf, visited on 28.04.2009

D. W. Urvin, *A History of European Integration Since 1945***.** London: Longman Publisher, 1995

S. Walmann, *The Boundaries of Race: Processes of Ethnicity in England*, Man vol.1 no.2, 1978

M. Wintle, *Culture and Identity in Europe: Perceptions of divergence and unity in past and present.* Oxford: Avebury, Ashgate Publishing Ltd, 1996

# CORPORATE GOVERNANCE: PROBLEMS AND RELATIONSHIP BETWEEN BOARD OF DIRECTORS, THE CHIEF EXECUTIVE OFFICER, AND TOP MANAGEMENT

## Integration To European Banking Legislation

**Güran Yahyaoğlu**
**Çanakkale 18 Mart University, Turkey**

## ABSTRACT

International economic crises demonstrated however it isn't possible to prevent, countries try to overcome with little damage by setting a kind of early caution alarm system. Each country according to its internal dynamics and developing systems one hand tries to tie similar rules on the otherhand sould take consideration each countries internal dynamics and parameters. Because, in each country there is a historical period which causes coming out valid systems and institutions. If a system which apply in a country of world we try to apply to another country exactly the same way surely it come about inapplicable ways.

Corporate governance is principle list offering well management method with transparency, accountability, responsibility, and equity principles. For ever corporation, performing of these principles is key to reach successful administration and so important. However, corporate governence presents different importance for banks because of its existing responsibilites and obligations. Sound corporate governance can contribute to a collaborative working relationship between bank management and bank supervisors. Recent sound practice papers issued by the Basel Committee underscore the need for banks to set strategies for their operations and establish accountability for executing these strategies. In addition, transparency of information related to existing conditions, decisions and actions is integrally related to accountability in that it gives market participants sufficient information with which to judge the management of a bank.

## TABLE OF CONTENT

# 1. General Overview Of Banking And Corporate Governance

The fluctuations in the banking sector cause to damage individuals, tradesmen, firms having commercial and corporate natures in the financial meaning except ascribing the damages to public. Capital adequacy is minumum level at the developing countries, almost all working capital, requirements and investment financing are met by bank credits. In the periods of bank bankruptcy fluctuations in the big scale shall be realized and bank depositors and small investors having bank stocks via public offerings shall be damaged. They have responsibilities against bank depositors, small partners and all enterprises whose liquidity is supported by them except their duties and responsibilities related to their own legal entity. For these reasons, the banks should be well-managed.

Corporate governance is principle list offering well management method with transparency, accountability, responsibility, and equity principles. For ever corporation, performing of these principles is key to reach successful administration and so important. However, corporate governence presents different importance for banks because of its existing responsibilites and obligations.

There has been a great deal of attention given to the issue of corporate governance in various national and international fora. In particular, the OECD has issued a set of corporate governance standards and guidelines to help governments "in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance." (OECD Principles of Corporate Governance)

As part of its on-going efforts to address supervisory issues, the Basel Committee on Banking Supervision has been active in drawing from the collective supervisory experience of its members and other supervisors in issuing supervisory guidance to foster safe and sound banking practices. The Committee is publishing this paper to reinforce the importance for banks of the OECD principles, to draw attention to corporate governance issues addressed in previous Committee papers, and to present some new topics related to corporate governance for banks and their supervisors to consider.

Banking supervision cannot function as well if sound corporate governance is not in place and, consequently, banking supervisors have a strong interest in ensuring that there is effective corporate governance at every banking organisation. Supervisory experience underscores the necessity of having the appropriate levels of accountability and checks and balances within each bank. Put plainly, sound corporate governance makes the work of supervisors infinitely easier. Sound corporate governance can contribute to a collaborative working relationship between bank management and bank supervisors. Recent sound practice papers issued by the Basel Committee underscore the need for banks to set strategies for their operations and establish accountability for executing these strategies. In addition, transparency of information related to existing conditions, decisions and actions is integrally related to accountability in that it gives market participants sufficient information with which to judge the management of a bank.

We focus on a management structure composed of a board of directors and senior management. The Committee recognises that there are significant differences in the legislative and regulatory frameworks across countries as regards the functions of the board of directors and senior management. In some cases, it is known as a supervisory board. This means that the board has no executive functions. In other countries, by contrast, the board has a broader competence in that it lays down the general framework for the management of the bank. Owing to these differences, the notions of board of directors and senior management are used in this paper not to identify legal constructs but rather to label two decision-making functions within a bank. These approaches to boards of directors and senior management are sometimes referred to as corporate governance " structures".

The Basel Committee is an issue to supervisory authorities worldwide in the belief that it will assist supervisors in promoting the adoption of sound corporate governance practices by banking organisations in their countries. Recognising that different structural approaches to corporate governance exist across countries, practices which can strengthen corporate governance under diverse structures.

### 1.1. Corporate Governance in Banking

The OECD paper defines corporate governance as involving " a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently."

Banks are a critical component of any economy. They provide financing for commercial enterprises, basic financial services to a broad segment of the population and access to payments systems. In addition, some banks are expected to make credit and liquidity available in difficult market conditions. The importance of banks to national economies is underscored by the fact that banking is virtually universally a regulated industry and that banks have access to government safety nets. It is of crucial importance therefore that banks have strong corporate governance.

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management, affecting how banks:

• set corporate objectives (including generating economic returns to owners);
• run the day-to-day operations of the business;
• consider the interests of recognised stakeholders;

The Basel Committee has recently issued several papers on specific topics, where the importance of corporate governance is emphasised. These include Principles for the management of interest rate risk (September 1997), Framework for internal control systems in banking organisations (September 1998), Enhancing bank transparency (September 1998), and Principles for the management of credit risk (issued as a consultative document in July 1999). These papers have highlighted the fact that strategies and techniques that are basic to sound corporate governance include:

• the corporate values, codes of conduct and other standards of appropriate behaviour and the system used to ensure compliance with them;
• a well-articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured;
• the clear assignment of responsibilities and decision-making authorities, incorporating a hierarchy of required approvals from individuals to the board of directors;
• establishment of a mechanism for the interaction and cooperation among the board of directors, senior management and the auditors;
• strong internal control systems, including internal and external audit functions, risk management functions independent of business lines, and other checks and balances;
• special monitoring of risk exposures where conflicts of interest are likely to be particularly great, including business relationships with borrowers affiliated with the bank, large shareholders, senior management, or key decision-makers within the firm (e.g. traders);
• the financial and managerial incentives to act in an appropriate manner offered to senior management, business line management and employees in the form of compensation, promotion and other recognition; and
• appropriate information flows internally and to the public.

The reality that various corporate governance structures exist in different countries reflects that there are no universally correct answers to structural issues and that laws need not be consistent from country to country. Acknowledging this, sound governance can be practised regardless of the form used by a banking organisation. There are four important forms of oversight that should be included in the organisational structure of any bank in order to ensure the appropriate checks and balances: (1) oversight by the board of directors or supervisory board; (2) oversight by individuals not involved in the day-to-day running of the various business areas; (3) direct line supervision of different business areas; and (4) independent risk management and audit functions. In addition, it is important that key personnel are fit and proper for their jobs. Government ownership of a bank has the potential to alter the strategies and objectives of the bank as well as the internal structure of governance. Consequently, the general principles of sound corporate governance are also beneficial to government-owned banks.

### 1.2. Critical Elements Of Bank Corporate Governance Process

As mentioned, supervisors have a keen interest in determining that banks have sound corporate governance. The following discussion draws on supervisory experience with corporate governance problems at banking organisations and suggests the types of practices that could help to avoid such problems. These practices should be viewed as critical elements of any corporate governance process.

### 1.2.1. Strategic Objectives

It is difficult to conduct the activities of an organisation when there are no strategic objectives or guiding corporate values. Therefore, the board should establish the strategies that will direct the ongoing activities of the bank. It should also take the lead in establishing the " tone at the top" and approving corporate values for itself, senior management and other employees. The values should recognise the critical importance of having timely and frank discussions of problems. In particular, it is important that the values prohibit corruption and bribery in corporate activities, both in internal dealings and external transactions. Processes should be established that allow the board to monitor compliance with these policies and ensure that deviations are reported to an appropriate level of management.

### 1.2.2. Responsibility and Accountability

Effective boards of directors clearly define the authorities and key responsibilities for themselves, as well as senior management. They also recognise that unspecified lines of accountability or confusing, multiple lines of responsibility may exacerbate a  through slow or diluted responses. Senior management is responsible for creating an accountability hierarchy for the staff, but must be cognisant of the fact that they are ultimately responsible to the board for the performance of the bank.

### 1.2.3. Qualifications of Board Members

The board of directors is ultimately responsible for the operations and financial soundness of the bank. The board of directors must receive on a timely basis sufficient information to judge the performance of management. An effective number of board members should be capable of exercising judgement, independent of the views of management, large shareholders or governments. Including on the board qualified directors that are not members of the bank's management, or having a supervisory board or board of auditors separate from a management board, can enhance independence and objectivity. Moreover, such members can bring new perspectives from other businesses that may improve the strategic direction given to management, such as insight into local conditions. Qualified external directors can also become significant sources of management expertise in times of corporate stress. The board of directors should periodically assess its own performance, determine where weaknesses exist and, where possible, take appropriate corrective actions.

### 1.2.4. Senior Management

Senior management is a key component of corporate governance. While the board of directors provides checks and balances to senior managers, similarly, senior managers should assume that oversight role with respect to line managers in specific business areas and activities. Even in very small banks, key management decisions should be made by more than one person. Senior management consists of a core group of officers responsible for the bank. This group should include such individuals as the chief financial officer, division heads and the chief auditor. These individuals must have the necessary skills to manage the business under their supervision as well as have appropriate control over the key individuals in these areas.

### 1.2.5. Recognition Of The Important Control Function

The role of auditors is vital to the corporate governance process. The effectiveness of the board and senior management can be enhanced by: (1) recognising the importance of the audit process and communicating this importance throughout the bank; (2) taking measures that enhance the independence and stature of auditors; (3) utilising, in a timely and effective manner, the findings of auditors; (4) ensuring the independence of the head auditor through his reporting to the board or the board's audit committee; (5) engaging external auditors to judge the effectiveness of internal controls; and (6) requiring timely correction by management of problems identified by auditors. The board should recognise and acknowledge that the internal and external auditors are their critically important agents. In particular, the board should utilise the work of the auditors as an independent check on the information received from management on the operations and performance of the bank.

### 1.2.6. Ethical Values, Objectives, Strategy And Control Environment

Failure to link incentive compensations to the business strategy can cause or encourage managers to book business based upon volume and/or short-term profitability to the bank with little regard to short or long-term risk consequences. This can be seen particularly with traders and loan officers, but can also adversely affect the performance of other support staff.

The board of directors should approve the compensation of members of senior management and other key personnel and ensure that such compensation is consistent with the bank's culture, objectives, strategy and control environment. This will help to ensure that senior managers and other key personnel will be motivated to act in the best interests of the bank.

In order to avoid incentives being created for excessive risk-taking, the salary scales should be set, within the scope of general business policy, in such a way that they do not overly depend on short-term performance, such as short-term trading gains.

**1.2.7. Transparency**

As set out in the Basel Committee's paper Enhancing bank transparency, it is difficult to hold the board of directors and senior management properly accountable for their actions and performance when there is a lack of transparency. This happens in situations where the stakeholders, market participants and general public do not receive sufficient information on the structure and objectives of the bank with which to judge the effectiveness of the board and senior management in governing the bank. Transparency can reinforce sound corporate governance.

**1.2.8. Supportive Environment**

The Basel Committee recognises that primary responsibility for good corporate governance rests with boards of directors and senior management of banks; however, there are many other ways that corporate governance can be promoted, including by:

- governments – through laws;
- securities regulators, stock exchanges – through disclosure and listing requirements;
- auditors – through audit standards on communications to boards of directors, senior management and supervisors; and
- banking industry associations – through initiatives related to voluntary industry principles and agreement on and publication of sound practices.

The International Accounting Standards Committee defines related parties as "those able to control or exercise significant influence. Such relationships include: (1) parent-subsidiary relationships; (2) entities under common control; (3) associates; (4) individuals who, through ownership, have significant influence over the enterprise and close members of their families; and (5) key management personnel". The IASC expects that disclosures in this area should include. (a) the nature of relationships where control exists, even if there were no transactions between the related parties; and (b) the nature and amount of transactions with related parties, grouped as appropriate.

**1.2.9. Supervisors**

Supervisors should be aware of the importance of corporate governance and its impact on corporate performance. They should expect banks to implement organisational structures that include the appropriate checks and balances. Regulatory safeguards must emphasise accountability and transparency. Supervisors should determine that the boards and senior management of individual institutions have in place processes that ensure they are fulfilling all of their duties and responsibilities.

A bank's board of directors and senior management are ultimately responsible for the performance of the bank. As such, supervisors typically check to ensure that a bank is being properly governed and bring to management's attention any problems that they detect through their supervisory efforts. When the bank takes risks that it cannot measure or control, supervisors must hold the board of directors accountable and require that corrective measures be taken in a timely manner. Supervisors should be attentive to any warning signs of deterioration in the management of the bank's activities. They should consider issuing guidance to banks on sound corporate governance and the pro-active practices that need to be in place. They should also take account of corporate governance issues in issuing guidance on other topics.

## 2. Development Stages Of Corporate Governance In European Countries And U.S.

In the last 15 years, reforms have been enacted in European countries to improve internal governance mechanisms, empower shareholders, enhance disclosure, and strengthen public enforcement. To understand the impact of these reforms, it is helpful to start by offering some comparisons with the United States. In the United States, the directors make all the decisions (or have an exclusive power to initiate them if a shareholder vote is mandated). In Europe, shareholders have a final say on a larger number of issues, such as share buy-backs, dividendpayments, and new issues. European shareholders also have much greater power toset the shareholder meeting agenda (Cools, 2005). This allocation of power backs up the prevailing ownership structures: in both cases, the law grants the controllers (management in the United States, dominant shareholders in Europe) the right to exercise and retain control.

The U.S. central government has long played a much more important role in regulating corporate governance than the European Community on the other side of the Atlantic: U.S. securities regulation has developed since the 1930s and deals with many crucial corporate governance issues, such as shareholder meetings and voting, insider trading, takeovers, securities fraud, and now, with the Sarbanes–Oxley Act, even board composition and functioning (Roe, 2003). By contrast, the European Community, despite its power to enact binding regulations and directives in corporate law matters, has traditionally had a much lower impact on European companies' corporate governance (Enriques, 2006). Furthermore, U.S. securities regulation provides for a system of mandatory disclosure that is traditionally far more comprehensive than Europe's. Its effectiveness is ensured by an aggressive set of enforcement institutions, such as the securities plaintiff bar (lawyers who bring class action suits on behalf of large numbers of investors), the Securities and Exchange Commission (SEC), and the U.S. Department of Justice. In Europe, enforcement is in the hands of member states, which have traditionally been far from aggressive in tackling violations of corporate and securities laws via public enforcement. With no plaintiff bar and long-standing legal hurdles to shareholder litigation, private enforcement of directors' duties is almost unheard of. This pattern is in sharp contrast with the United States, where corporate directors face a high risk of being sued if they engage in self-dealing. When such a lawsuit occurs, the courts, especially in Delaware, are very strict in judging a director's loyalty to the corporation. While the various continental European corporate governance systems can look rather similar, especially when compared with the U.S. system, each also has its own distinctive traits.

### 2.1. Corporate Governance Reforms in France, Germany, and Italy

Corporate governance in continental Europe traditionally differs from that in the United States in two important ways: first, most European companies have controlling shareholders, while most American corporations are widely held; second, the regulations on self-dealing have traditionally been stricter in the United States.

In the last 15 years, France, Germany, and Italy have enacted significant corporate law reforms to strengthen the mechanisms of internal governance, empower shareholders, enhance disclosure requirements, and toughen public enforcement. Special emphasis was placed on empowering minority shareholders and on disclosure, which are the most effective tools for countering abuses by dominant shareholders. However, before concluding the reforms have benefited investors, a few words of caution are in order. First, far too little has been done to resolve the problem of related-party transactions, which is the most common form of self-dealing for dominant shareholders in Europe. Germany has done nothing to improve its law on this matter. France and Italy have introduced stricter rules on such transactions but have not done enough to strengthen private enforcement, making them effective in the real world. Second, a good part of the European reforms have been patterned after U.S. corporate and securities law. America does have a well-developed legal framework for corporate governance, which has been further improved by the post-scandal reforms. However, the fundamental differences in ownership structure between Europe and the United States mean that emulating laws whose focus is on curbing managerial opportunism may not be an appropriate way to prevent self-dealing by controlling shareholders. Indeed, a cynical observer might argue that when European policymakers adopt U.S.-style solutions designed to tackle managerial agency problems, they can appear to be doing something to reform European corporate governance while actually leaving the rents of Europe's dominant shareholders perfectly intact. In view of its recent evolution, corporate governance law in Europe is often described as being in a "state of permanent reform" (Noack and Zetzsche, 2005). The reform effort needs to continue if continental Europe is to address in an effective manner the basic problems of corporate governance that are posed by the power of dominant shareholders.

German law mandates a two-tier board structure, made up of a "supervisory board" and a "managerial board." In companies with more than 2,000 employees, the supervisory board must be composed of equal numbers of shareholder-elected and employee-chosen members (so-called "co-determination"). Banks have traditionally played a central role in the supervisory boards of listed companies, as a result of their shareholdings and of their acting as their clients' proxies in shareholder meetings (Fohlin, 2005). Unsurprisingly, supervisory boards, packed with employees and bank representatives, have been quite ineffective in monitoringn management (and dominant shareholders) on behalf of outside investors (Theisen, 1998).

In France, managerial power has historically been concentrated in the hands of the chief executive officer, who, by law, also acted as chairman of the board. At least on paper, corporate law has traditionally been friendlier to minority shareholders in France than in Germany or Italy. As one example, individual shareholders of French companies have long been able to sue directors derivatively and a special regime has always applied to related-party transactions involving board members: these transactions need to be approved by the board and ratified by the shareholder meeting, unless they are deemed to be routine "current transactions entered into at normal conditions." In general, however, judges and practitioners have traditionally provided a mild interpretation of this regime; for example, by classifying most transactions with companies of a same group as routine (Enriques, 2004).

In Italy, a separate board of auditors—an internal body composed exclusively of formally independent members—has traditionally performed the internal audit functions. Neither the board of directors nor the board of auditors have ever been able to exercise effective control over managers (and hence over the dominant shareholders who appoint them), as the Parmalat scandal vividly illustrated. More generally, Italian corporate law has historically provided poor protection for investors, while enforcement institutions, like courts or the Italian securities and exchange commission (Consob), have been unable to make up for the deficiencies of the law (Aganin and Volpin, 2005).

Three main factors have driven the reforms in continental European corporate governance over the last two decades. First, reforms aimed to make national capital markets more attractive at a time when international competition for equity capital was increasing due to deregulation, globalization, and large-scale privatizations (Kamar, 2006). Second, changes were spurred as part of the European Community's efforts to institute a common regulatory framework for European financial markets, especially on disclosure issues (Ferran, 2004). Finally, many of the corporate law reforms recently enacted in Europe have come as a response to corporate scandals, including both the well-publicized cases like Enron and Parmalat, and many other scandals, like the recent financial frauds in France and Germany discussed in Enriques (2003). For example, a 1998 German corporate governance reform was enacted after Metallgesellschaft and other corporate scandals exposed German corporations' defective internal control mechanisms (Cioffi, 2002).

The discussion that follows highlights the efforts of lawmakers to enact corporate governance reforms that may help protect minority shareholders of corporations. For general overviews of European corporate law reforms, see Nowak (2004) and Noack and Zetzsche (2005) (Germany); Conac (forthcoming) (France); and Bianchi and Enriques (2005) and Ferrarini, Giudici, and Stella Richter (2005) (Italy). Enriques and Gatti (2006) provide an overview of recent reforms at the European Community level.

**2.2. Strengthening Internal Governance Mechanisms**

In the wake of U.S. scandals, reforms enacted by the U.S. Congress and the main stock exchanges have required that a majority of directors be independent, that audit committees be entirely composed of independent directors and that companies have adequate internal control mechanisms. Further, independence requirements have been tightened and audit committees' powers and responsibilities have been extended. Finally, attempts to curb self-dealing have been imposed by requiring that companies have a compensation committee entirely composed of independent directors and by banning corporate loans to directors. None of the European countries considered here have gone as far as the United States in their attempts to strengthen internal governance mechanisms.

In Germany, the 1998 reform sought to improve internal corporate governance by redefining the functions of both the management board and the supervisory board. The management board now must ensure that adequate risk management and internal audit systems are in place and must report to the supervisory board over risk management issues, budget, and business plans. Supervisory boards must meet at least four times a year and have an increased role in the choice of, and relationship with, the auditor.

French law has done little to empower the board of directors, other than to allow companies to separate the roles of chairman of the board and chief executive officer. Some attempts were made to give more information to directors from outside the firm. In 2001, a new law stated that "each director should receive all information needed to fulfill his duties" and that "each director can obtain any and all documents that he sees fit to request" (Menjucq, 2005, p. 702). But two years later, French lawmakers scrapped the latter provision, preventing individual board members from accessing the company's documents directly.

In Italy, reforms strengthened internal governance mechanisms by requiring that executive directors regularly inform the board of directors and the board of auditors of business developments and related-party transactions, and most importantly, that at least one director and one board-of-auditors member be elected by minority shareholders. The reforms also entrusted the board of auditors with greater powers and somewhat tightened their members' independence requirements.

France and Italy have strengthened their rules on self-dealing transactions by dominant shareholders. France made its special regime on directors' related-party transactions also applicable to transactions involving the parent company or any shareholder holding more than 10 percent of the voting rights and to executive compensation packages granting a lump-sum bonus at the time of appointment or dismissal.

In its 2003 corporate law reform, Italy revised its previously lax regime on self-dealing transactions to "strengthen its prophylactic character" (Ferrarini, Giudici, and Stella Richter, 2005, p. 680). Directors now have to disclose to the whole board and to the board of auditors any direct or indirect interest they might have in a transaction. Prior board-of-directors approval is required for transactions in which the chief executive officer has an interest. While interested directors need not abstain from voting, the board resolution must "adequately explain the reasons for the transaction and the benefits deriving to the company" (p. 681). This mandatory justification of the transaction's fairness has to be more detailed and analytical when the corporation decides for it under the influence of its parent company. By contrast, no new internal governance rules for related-party transactions have been enacted in Germany over the past 15 years.

### 2.3. Empowering Shareholders

In the United States, shareholders have become louder and more powerful. The two main stock exchanges amended their listing rules in 2003 to require shareholder approval of stock-based compensation plans, and also prohibited brokers from voting their clients' shares to approve such plans, unless the clients instruct them on how to vote. Restrictions on brokers' discretionary voting (they usually back management's proposals) are now being discussed with reference to board elections, an issue where recent developments at the state and federal level have strengthened shareholders' power (Klingsberg, 2006; for the policy debate see Bebchuk, 2005, and Bainbridge, 2006). Lawmakers in continental Europe have taken various steps to increase minority shareholders' powers vis-a`-vis managers and dominant shareholders. They have strengthened shareholders' voice in corporate governance. Shareholders now have the power to authorize or ratify some transactions and resolutions in potential conflict of interest. As noted, in France the general meeting has to ratify any nonroutine transactions with a major shareholder and some forms of executive compensation. In Italy, a specific provision now requires the meeting's approval of any form of stock-based compensation.

In each of the three countries, shareholders now face lower costs for voting. Companies can allow remote voting via Internet and telecommunications technology. France and Germany have also introduced rules to reduce technical barriers to voting by shareholders residing abroad and to facilitate the circulation of documents, including shareholder proposals, prior to the meeting. Italian companies' shareholders formerly had to deposit their shares with a bank five days prior to the meeting, which prevented them from selling their shares during those five days and hence severely discouraged voting, especially by institutional investors. In 2003 this provision was repealed; the default rule is now no deposit obligation, although company bylaws may require an up to two-day deposit obligation. No such requirement exists in Germany, where a new law has clarified this point. In France, corporate bylaws can require the deposit of shares for up to five days prior to the meeting, but a 2002 decree provides that shareholders remain free to sell their shares up until the day before the meeting.

To limit the power of controlling shareholders, special majorities for "nonroutine" shareholder resolutions have traditionally been in place in France and Germany. In Italy, since 1998, a two-thirds majority of the shares represented at the meeting has been required for various kinds of resolutions, including new issues, mergers, and amendments to the bylaws. The purpose is to allocate some power to large minority shareholders, in hopes that they monitor the controlling shareholder. France and Italy also lowered the ownership thresholds for some minority shareholder rights, such as the right to call a meeting.

### 2.4 Corporate Governance And Banking Law In Turkey

In the context of Turkish Banking Law in the code of 5411 coporate governance is handled. The first part allocated for "Management" and Principles of corporate governance, Board of directors, Audit committee, General manager and deputy general managers, Prohibition from working and signing, Oath and declaration of property, Docket, are cited as subtitles. The second section "Internal Systems" includes Obligations pertaining to internal systems, Internal control system, Risk management system, Internal audit system. Section three is alluded for "Authorized Institutions" and consists of the code of Independent audit firms, Valuation and rating institutions, Outsourcing institutions, Liability insurance. And "Financial Reporting" committed in section four involves in Accounting and reporting system, Consolidated financial reports, Signing, submission, announcement and auditing of financial reports, Annual activity report, Responsibility and Record keeping.

Turkey is a country in the French tradition. One of the building blocks of CG legislative framework, the Commercial Code (CC), was originally taken from French Commercial Code in 1850 and amended in 1926 and 1956 – with provisions taken from German, Swiss and Italian law. The 1956 version, with its evidently eclectic nature, forms the basis of equity contract and provides the legal framework for incorporation, general assemblies, shareholder rights, definition of shares and bonds and their issuance. The CML had provisions taken from the Anglo-Saxon (common law) legal system but still has its roots in civil law. It primarily provides the legislative framework for securities market activities and establishes the CMB. Separate laws regulate the banking and insurance sectors. A major issue of legislation is related with the ambiguities in law and inconsistencies between Commercial Code, Capital Markets Law and Banking Law with respect to disclosure, accounting, taxation and shareholder rights.

Governance is ultimately concerned with the alignment of information, incentives and capacity to act' (Monks and Minow, 1995). It involves the monitoring of the corporation's performance and the monitor's ability to observe and respond to that performance. Insufficient and unclear information may hamper the ability of the markets to function, increase volatility and the cost of capital, and result in poor allocation of resources (La Porta et al. 2000). It is apparent that market forces for transparency would be weaker where ownership is concentrated and related lending by banks form major source of governance. This partially explains the lack of strong disclosure tradition in Turkey. Dependencies in standards of transparency and accountability allow corporate management to avoid disclosure and manipulate markets by misinformation. These weaknesses are conduit to asset transfers and asset stripping. According to Gilson (2000), effective disclosure requires legally mandated disclosure requirements, good accounting standards, independent auditors, and enforcement. These standards are highly significant in ensuring that stakeholders have sufficient, timely, credible, comprehensible and cost-effective information to monitor the company's performance.

Despite the differences in starting points and paths followed, a trend towards convergence of corporate governance regimes has been developing (Nestor and Thompson, 1999). However, convergence does not imply that reform plans should be identical. Lessons derived from recent, post-crises reform experiences show that no single model of corporate governance will adequately solve the governance issues in every situation and each country should formulate its own reform plan that suits its specifc conditions.

Existence of an independent and alert media sensitive to and capable of detecting corporate mis-conduct and politically-endorsed tunneling is essential. Given the highlymonopolized status of the media in Turkey, this issue needs special attention. Last but not the least, in pursuing a membership status in European Union, Turkey should align its reform initiatives to the developments in Europe to harmonize company law.

## 3. Conclusion

In the past liberty and originality are basic for internal affairs of coutries. Due to globalization law terminology have also changed as military and political understanding. 30- 40 years ago for a quarrel in a family neighbours couldn't get possetion of hearing and could seem this problem as their own problem today meeting a quarrel in family, neighbours can say “although being in your house you disturb us” and can ask for discretion fort this statement.

Today when we take consider coutries as an example of Malaysia we see, it can't calculate its own extenal loan due to current changing calculation methods. In the past, countries were not affected due to like this situation. Today this statement affect also other countries. Via electronic keys hot money transition is provided in seconds and this affects the countries which the money comes from and goes to. As known, due to globalization destructive effects of economic crisis has been more. In 1997 starting with Southeast Asian Crisis, last 15 years crisis affects countries more.

When international economic crises are examined we see however it isn’t possible to prevent, countries try to overcome with little damage by setting a kind of early caution alarm system. Each country according to it’s internal dynamics developing systems one hand tries to tie similar rules on the otherhand sould take consideration each countries internal dynamics and parameters. Because, in each country there is a historical period which causes coming out valid systems and institutions. If a system (strategic management) which apply in a country of world we try to apply to another country exactly the some way surely it come about inapplicable ways. Namely, when individual B wear individual A‘s jacket it’ll be lease or close- fitting. But it’s a real that we must go on working for adaptation.

Regrettably, I ought to acknowledge that fundamentally also being a supporter, my country's adaptation process to EU laws has as much as benefits, due to imcompatible situation with country's real, there seems unfavourable results and these unfavourable results coming about Turkish banks have big mistakes. For example, Banks, contrary to law which go into effect in 1985 "Banks have to investigate the individual's identity(reliable person or not) to hand checkook." handed out lots of checkbook without enough examination. Lots of person who had blank chegue papers used these or effectuated so caused lots of harmful result's coming about. Similar situation valid for credit cards.

Before 1985 individuals who put on uncovered cheque accepted as swindler and fined as to Turkish criminal Law in 1985 the crime of putting on uncovered cheque was percevided as an economic crime, and the fines were lessened.In international law as a consequence of changing human rights understanding the person who put on uncowered cheque won’t get jail puishment has been prevailed. As a part of adaptation Turkish laws to EU laws, now this process fine also come about abolition point. As a result of this understanding in Turkey trade have come about stop position. That this causes economic crises.

By no means, I am not against international legal principle but at this point we have experienced that, contemporary rules and contemporary management forms and base sometimes pan out negative results. At this point the case we have faced with is the lack of auditing and infirmity. Today in İstanbul if a merchant in bad faith(with corrupted intended) depart his area and goes on trading in a close area; he may not be discovered for months, maybe years. But think of a country, a person who has given a check is hurriying to the bank to pay his check on time. Unless he doesnt pay, he will get into a fix that he can't supply a want (register office and minicipal don't do anything, can’t shop, take credit cards etc.) For the two countries in the example the arrangement that will be brought should be different. This statement is a typical indicator to administration weakness, strategic administration weakness and Bank's contrary behaviour to social responsibility conciousness. Whereas Banks are a reliance instituations. Existence aim primarily encourage possesion of community and make credit system not as a way of sabotaging standart flow of trade life but, contrarily as a way of getting acceleraion an facilitate. There are lots of statements as an example of a general strategic administration weakness. As indicated above, internal economic crisis may even be exactly due to strategic administration weakness. I'm not an economist, I'm jurist SO, I don't want to hang up my profession but, I'm a bank jurist and I know how banks manage economy in other word, how economy is managed via banks. Releated to managing of these, methods and basis arrenged by rules and laws it gets province of law.

## REFERENCES

Aganin, Alexander, and Paolo Volpin, (2005), The History of Corporate Ownership in Italy, In A History of Corporate Governance around the World, ed. Randall K. Morck, pp.325-361. The University of Chicago Press, Chicago and London.

Basel Committee on Banking Supervision, (1997), Core Principles for Effective Banking Supervision, www.bis.org/ publ/bcbs30a.pdf

Bianchi, Marcello, and Enriques, Luca, ( 2005), Corporate Governance in Italy after the 1998 Reform: What Role for Institutional Investors?, Corporate Ownership & Control, 2(4), pp.11-31.

Cioffi, John W., (2002), Reforming 'Germany Inc.': The Politics of Company and Takeover Law Reform in Germany and the European Union, Law & Policy, 24(4), pp.355-402.

Cools, Sofie, (2005), The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers, Delaware Journal of Corporate Law, 30(3), pp.697-766.

Enriques, Luca, (2003), Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms, Wake Forest Law Review, 38(3), pp. 911–34.

Enriques, Luca, (2004), Book Review: The Comparative Anatomy of Corporate Law, American Journal of Comparative Law, 52(4), pp.1011-36.

Enriques, Luca, (2006), EC Company Law Directives and Regulations: How Trivial Are They?, University of Pennsylvania Journal of International Economic Law, 27(1), pp.1-78.

Enriques, Luca, and Matteo Gatti, (2006), EC Reforms of Corporate Governance and Capital Markets Law: Do They Tackle Insiders' Opportunism?, http://papers.ssrn.com/sol3/papers. cfm?abstract_id_886345.

Ferran, Eilı´s, (2004), Building an EU Securities Market, Cambridge University Press, Cambridge.

Ferrarini, Guido A., Paolo Giudici, and Mario Stella Richter, (2005), Company Law Reform in Italy: Real Progress?, Rabels Zeitschrift fu¨r ausla¨ndisches und internationales Privatrecht. 69(4), pp.658-97.

Fohlin, Caroline, (2005), The History of Corporate Ownership and Control in Germany, In A History of Corporate Governance around the World, ed. Randall K. Morck, 223-277, The University of Chicago Press, Chicago and London.

Gilson, Ronald J., (2000), Unocal Fifteen Years Later (And What We Can Do About It), http://papers.ssrn.com/ sol3/papers.cfm?abstract_id=235417

Kamar, Ehud, (2006), Beyond Competition for Incorporations, Georgetown Law Journal. 94(6), pp.1725–70.

Klingsberg, Ethan, (2006), New Court Decisions,Regulatory Positions and Legislation Provide New Tools for Stockholder Activists: Increases in Stockholder-Adopted By-laws and Proxy Contests on the Horizon, Cleary Gottlieb M&A and Corporate Governance Report, http://www.cgsh.com/ files/tbl_s47Details%5CFileUpload265%5C-646%5CCGSH_72-2006.pdf.

La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer, (2000), Corporate Ownership Around the World, Journal of Finance, 54(2), pp.471-517.

Menjucq, Michel, (2005), The Company Law Reform in France, Rabels Zeitschrift fu¨r ausla¨ndisches und internationales Privatrecht, 69(4), pp.698-711.

Monks and N. Minow, (1995), Corporate Governance, pp. 7-16 and 84-104.

Nestor, S. and Thompson, J., (1999), Corporate Governance Patterns in OECD Economies: Is Convergence Under Way?, Conference on Corporate Governance in Asia: A orporative Perspective, March, pp.3-5, Seoul

Noack, Ulrich, and Zetzsche, Dirk A., (2005), Corporate Reform in Germany: The Second Decade, European Business Law Review, 16, pp.1033-64.

Nowak, Erik, (2004), Investor Protection and Capital Market Regulation in Germany, In The German Financial System, ed. Jan P. Krahnen and Reinhard H. Schmidt, pp.425-49, Oxford University Press, Oxford.

OECD, (2004), Principles of Corporate Governance, www.oecd.org// …/princples.htm.

Roe, Mark J., (2003), Delaware's Competition, Harvard Law Review, 117(2), pp.588-646.

Theisen, Manuel R., (1998), Empirical Evidence and Economic Comments on Board Structure in Germany In Comparative Corporate Governance: The State of the Art and Emerging Research, ed. Klaus J. Hopt, Hideki Kanda, Mark J. Roe, Eddy Wymeersch, and Stefan Prigge, pp.259-65, Oxford University Press, Oxford.

# *STRATEGIC LEADERSHIP & STRATEGIC ALLIANCES & AMBIDEXTERITY*

# HOSTING STRATEGIC CONVERSATIONS: SOME ALTERNATIVE APPROACHES FOR LEADERS

**Marius Ungerer**
**University of Stellenbosch Business School, South Africa**

## ABSTRACT

*The main object of this paper is to introduce alternative ways for leaders in organisations to think about the way they execute their strategy-making processes. Strategic conversations are positioned as an alternative and/or complementary process to traditional formal strategising processes. Strategic conversations focus on unlocking the collective wisdom inherent in an organisation. This requires from a leader to use his/her power and influence to create conditions that are conducive for new ideas to emerge. Three specific strategic conversation approaches are described with illustrative mini case studies to guide leaders in exploring a new way of learning through interacting with stakeholders of the firm.*

## INTRODUCTION

The influential role of leaders in the process of creating and executing sustainable business strategies is a well acknowledged pattern in strategy literature (Gratton, 2000; Hamel, 1996; Porter, 1996). Hamel (1996:75-77) indicates that the challenge for leaders is inter alia to engage "revolutionaries" in the strategy-making process and to extend the strategy franchise beyond traditional constituencies to solicit diverse perspectives from younger employees, regional and customer-facing employees, middle management and newcomers in the organisation. Porter (1996:77) warns us about the potential danger of unravelling and compromising core strategic choices and positions of the firm by employees who do not understand the sensitivity and the fragility of a strategic direction. He also emphasises that the role of leadership is more than just coordinating individual functions. "Its core is strategy: defining and communicating the company's unique position, making trade-offs, and forging fit among activities. The leader must provide the discipline to decide which industry changes and which customer the company will respond to, while avoiding organizational distractions and maintaining the company's distinctiveness." (Porter, 1996:77). Gratton (2000: 204-205) encourages leaders to engage in collective dreaming and to build an organisation that values people.

Leadership can be described as the application of personal power and voice within the context of moral constraints and boundaries of a system (Nel & Beudeker, 2009:2). What can leaders then do to use their personal power and voice more effectively to lead a strategy development and implementation processes that create opportunities and space (physical and intellectual) for individual and collective learning? How can leaders be more present and visible to lead the strategy-making process in the firm?

This paper explores the options and approaches for strategic leaders to engage participants in the strategy-making process through strategic conversation and dialogue to foster a culture of participation, high involvement and personal ownership. Research by Kaplan and Bienhocker (2003:72) confirmed that strategy review sessions which are structured as strategic conversations of two-way exchanges where participants learn, challenge and listen to each other, as opposed to strictly timed and PowerPoint rehearsed "dog and pony shows", produced a powerful vehicle for learning and action by all involved. This is the mindset where leaders are co-creators, facilitators and educators on the strategy of the firm. This represents a deliberate move away from centralised control towards the creation of an industrial democracy.

### Conversation as a key ingredient of the Strategic Process

The development of strategy is primarily a people-centric process, more specifically a communal, interactive process. The structuring of this interaction process is part of the "magic" that needs to be created to fully exploit the unique capabilities of the people involved in strategising. The strategic conversation is the "glue" and lifeblood of the strategic process, used in every step of strategising to unlock the collective wisdom inherent in an organisation. Conversation builds consensus and coalition and serves as the foundation for focused and sustained action (Ungerer, Herholdt & Pretorius, 2007: 303-304).

Conversations are core to strategy processes for the following reasons:

- ***Energy is released through conversations***. Conversation energises participants and provides a channel along which that energy can flow. Leaders' ability to facilitate this process is important because it keeps the conversation channel open.
- ***Strategic assumptions are surfaced***. Conversation is the only tool we have for challenging assumptions. If mental models and industry orthodoxies remain unexpressed, they are never examined; if they are not examined, they are never challenged; if they are not challenged they remain unchanged. New mental models and assumptions about the strategic landscape of the organisation are important sources of new and more competitive options for the organisation.
- ***Feedback loops are created.*** These loops enable leaders to take decisions under review and to change them to make the enterprise more sustainable. As leaders explore and explain their own thinking and perspectives they listen to themselves and test their position with participants in the conversation. This creates a basis for reflective feedback on the imperatives and challenges associated with the strategy.
- ***Deeper levels of meaning emerged.*** Conversation serves as the vehicle for exchanging meaning and what people value. The strategic conversation provides the necessary starting point for this exchange. Without conversation, there can be no exchange. If the top echelons of the organisation have a clear picture of where the organisation must go, they have only one way of sharing that with the whole organisation — the strategic conversation. Sharing in this context means that people not only hear the message, but make it their own. This amounts to more than a road-show or one-way managerial information sessions, but authentic dialogue — two-way talk. The sharing and exploring of key elements of the strategic architecture of the firm by leadership create a basis for deeper understanding by participants.
- ***Conversation is the root of informed action***. Through conversation we explore the strategic landscape, decide on viable goals and prioritise them. The strategic conversation creates the agenda for action and change in order to optimally "mine" the possibilities confronting the business. As soon as people are engaged in conversation it is impossible to disengage. Conversation by its very nature leads to more conversation. This is why conversation is not only one-way communication, but a dialogue. In dialogue meaning and value are not only exchanged, but new meaning and value emerges out of the conversation, i.e. dialogue creates new shared value and meaning. In this way conversation is deepened and new routes and possibilities are suggested and explored
- ***Conversation creates alignment***. Once the organisation has decided on a course of action best suited to its target market, conversation allows it to align all the stakeholders to deliver its strategic drives and initiatives to satisfy customer needs by sticking as closely as possible to the broad strategy and tactical plan. Where deviations from the planned delivery occur, conversation creates the necessary feedback loops to take corrective action. Enabling this process of gap-closing activities over time gives meaning to the emergent nature of strategy as a continues process of refinement and adjustment based on real experiences in the competitive environment and highlight the organisation's strategic pattern — the very heart of what it actually is (as opposed to what it thinks it is or what it wants to be for customers).

## THE NATURE OF THE STRATEGIC CONVERSATION PROCESS

Strategic conversations need to be imbedded in conditions that foster high engagement, transparency and democratic principles. The following guidelines, based on the work of Wheatley (1994), Wheatley and Kellner-Rogers (1996; 1998), are helpful underlying departure points for structuring strategic conversations to foster and create strategic organisational alignment:

**Principle 1: Involving people in changes that affect their lives is no longer a choice.**

In the democratised workplace, organisations no longer have the option not to involve people in changes that will affect their lives. People want to be involved, to be consulted and to co-create the organisation's future because they understand that it is an important part of their own future.

While engaged in the process of strategic conversation, people are creating the conditions (like new relationships, new understanding and deeper commitment) that will make implementation easier, faster and more successful.

**Principle 2: People in organisations resist commands and directives. They never just obey.**

In the modern workplace people will always resist commands and will only support what they create. If we make people part of conversations, relationships change and we begin to see ourselves as partners.

Even if we insist on obedience, we only gain it at the cost of those things that help us deal with change — insight, intelligence and a readiness to act on this organisational wisdom. If leaders understand the truth of this principle they can begin to practise the kind of management style advocated by the concept ***servant leadership***. The servant leader, in the first place, knows how ineffective the reliance on commands and directives is.

**Principle 3: Truth is a multi-dimensional concept. There are many perspectives on reality, each representing its own unique truth.**

No two people are alike, therefore we have different interpretations of what is going on, and we attach different meanings to things. Each of us constructs a reality that makes sense to him/her from our own, unique, personal point of view. As we listen and open ourselves to different ways of thinking, we allow new perspectives to inform our own understanding. This enables us to agree on a course of action and to support it wholeheartedly despite our differences.

Strategy terminology and concepts are always loaded with specific meaning. The challenge for the leader is therefore to create space for participants to build their own meaning and associations and to be open to be formed by the conversation interactions. This sets the platform to mine the rich diversity of multi-perspectives and to enhance current thinking and strategic positions.

**Principle 4: Connecting is the lifeblood of organisations.**

Systems have a natural tendency to run out of energy, called entropy. To counteract this, it must create more connections, both within the organisation and with its stakeholders. Intelligence emerges as the system connects to itself in diverse and creative ways. Like the human brain, the greater the connections and the greater the access to data and information, the higher the organisational intelligence. Viewed in this way, organisations are webs of connected conversations where information is exchanged.

A failing system needs to connect, especially with those it does not think of as part of itself e.g. customers, suppliers and eccentric and disenfranchised people on the fringes of the organisation. The quality and variety of connections are important because they enlarge the organisational information database.

Conversations increase the variety and strength of the connections needed for new information. If the intent with organisational strategy is to change the strategic pattern of the organisation, then strategic change starts with changing what we converse about and with who.

Leaders can consider the following ***key questions*** to enhance the quality and variety of organisational connections:

- Who else needs to be here?
- What new connections can we consciously create?
- What insights can we gain from these new connections?
- Are we using all the intelligence of the organisation?
- Who are we now as a web of new connections?

**Principle 5: Organisations have an inherent capacity to self-organise**

Whether organisational leadership leverage it or not, parts of the system will (naturally and without prompting) sort out their strategic possibilities and how these could be leveraged. Self-organisation is a natural and spontaneous phenomenon and develops around identity, relationships and information.

***Identity*** is the basis around which relationships are built. We are social by nature and we must relate to others (or die). Self-organising is driven by the need to belong. Paradoxically, identity is also driven by the need to differentiate — to be different, special, the best. In organisations identity manifests itself in purpose statements, branding, corporate identity, business and functional units, and organisational hierarchies. Groups of people will develop an identity over time. There is a natural need to define "who we are and what we stand for". Wise leaders use this energy in the strategic process.

***Information*** is the basic building block for meaning. It is not only a "thing" with specific characteristics (like quantity, bits or bytes) that can be counted, stored or transmitted, but dynamic and changing. Living organisations are not stable structures but a process of responding to and organising information. They continuously organise around information for new order to evolve and emerge. Organisational renewal depends on the generation of new information. If new information is not generated or if it merely confirms what is already known, the results will be stagnation and organisational decay. A prerequisite for self-organisation is the free flow of information. This means that information related to strategy needs to be accessible to all people engaging in the strategising process.

***Relationships*** connect the organisation to the intelligence inherent in the system. Without connections nothing happens. Relationships are the only sustainable, long-term source of information because these connections can be used again and again. Without relationships there are no connections, leading to organisational isolation and an information famine. Like in the brain, knowledge is born, not in the individual cells, but in the connections between them. The strategic conversation process is an opportunity for leaders to build mutual beneficial relationships with a variety of stakeholders to enhance the competitiveness of the firm.

The quality and impact of the strategic conversation process in organisations can be enhanced further by leaders through pursuing the routines of creating a spirit of enquiry, asking questions that matter, listening to deepen understanding and exhibiting both inquiry and advocacy behaviours.

## Creating a Spirit of Enquiry

Leaders can ***create a spirit of enquiry by doing the following:***

- Choose a setting where normal distractions are minimised. This does not mean a fancy retreat in some exotic location — merely one free from distractions like the telephone, secretaries, interruptions by operational crises, etc.
- Encourage an atmosphere of informality — no titles or rank; relaxation — an informal dress code; warm interpersonal relationships — be hospitable.
- Clarify the context by stating the purpose of the conversation and by authorising participants presence, especially if there are participants present who represent voices from domains of interest who are not traditionally part of the strategic conversation.
- Ensure that all voices are heard. Know that everyone in the group has part of the solution, but no one has it all (not even you as the leader).
- Acknowledge that anyone present may be uncomfortable with someone else's solution or perspective. Agree to discuss differences until there is sufficient consensus.
- Use innovative and interesting aids and tools (like graphics and colour and a shared working space) to help people "see" the flow of the conversation more easily.

## Asking Questions that Matter

Meaningful learning through conversation starts with relevant questions — questions that matter.
Powerful questions provoke thought, challenge assumptions, generate energy, focus enquiry, touch a deeper meaning and evoke further related and meaningful questions. A question that mobilises meaningful conversation has the following characteristics (Brown, 2002:11-12; Brown and Isaacs, 2005:165)

- The questioner does not know the answer. The answer to the question really matter to the questioner and it is not used to teach, to uncover incompetence, to cause embarrassment or to change anyone's personality. It raises issues that are not examined often enough. It tackles sacred cows, targets mental models, and addresses tough issues e.g. "Why are our results deteriorating despite the fact that we are working so much harder?"
- It examines things from different perspectives. It is simple, but not simplistic.
- It goes to the heart of the matter under discussion without sidestepping the "unspoken fears and/or fantasies" of participants.
- It provokes responses and participation. A question that matters makes you participate in the strategic conversation despite yourself — despite your own fears and inadequacies and the fact that others might be better qualified to answer than you. It motivates participants to contribute to the conversation no matter what.
- It creates a sense of deeper knowing and helps us learn more than we already know. It leaves you wondering and wanting to discover more.

The following questions can be used by leaders to **enhance the process and content of conversations:**

Some examples of useful *process questions* that will help any conversation along, especially if it got stuck, include (Ungerer *et al*. 2007: 310):

- Why do you say that?
- What questions will be useful for us to discuss right now?
- How can this challenge be a gift?
- What are we failing to notice?
- What belief, orthodoxy or mental model is operating here?
- What is possible?
- What one question, if answered, will make the most difference to our current situation?
- What will it look/feel like if this is no longer an issue?

Some examples of questions to enrich the *content* of discussions include (Ungerer et al. 2007: 311):

- Why is this a problem?
- What are the root causes?
- Who are the stakeholders? What power do they have and how satisfied are they?
- Who has to make the final decision?
- How will we measure success?
- How will we know the system is fulfilling its function?
- What is the history of the problem?
- Who owns the problem?
- How will we know the problem is solved?
- What unintended consequences could there be if we take this course of action?
- What alternatives are available? Why?
- How should we implement the solution?

## Listening to Deepen understanding

Someone said recently: "In a conversation some people pause only to reload." This phrase neatly captures the perspective of those who see conversation as a battleground of wills where they have to fight for their own idea to win. Real conversation is not a battle of wits and the most useful strategy is not to talk, but to listen.

Wisdom is held collectively and it takes both listening and conversation to bring it forth. The following tactics will enhance the listening capabilities of any leader and team:

- Listen actively — listen for common threads and themes. Often strategic conversations are about something more important than the topic.
- Listen for meaning. Don't just listen to the words, but hear the meaning behind them. Check with the speaker if you think you got it: "What I heard you say is …" Be prepared to be wrong and to change your position based on the answer you get.
- Not everyone is a trained speaker. Give ample time for stating views — enough time to phrase and rephrase.
- Do not reload — don't start composing a counter-argument in your head while someone is talking. Hear them out.
- Know that people are working when they are listening. Not everyone can talk at the same time, but everyone can listen at the same time. The level of listening is a reflection of the level of co-operation, co-creation and maturity in the team.
- Listen to your own inner reaction (and self-talk) to what is being said. Inner tension and stress usually mean that the conversation is touching some of your own preconceptions, beliefs and mental models. You learn a lot about yourself if you listen.

Two skills that build individual leadership capability to contribute to a strategic conversation are advocacy and inquiry.

## Inquiry and advocacy to enhance listening and responding

To make the most of conversation leaders should encourage high inquiry and high advocacy behaviour in themselves and others. Inquiry is the work of asking questions for clarity, probing deeper into an issue and helping others to learn. Advocacy is the work of making clear statements about what I know and think, taking a strategic conversation deeper and helping others to learn.

Inquiry and advocacy can be observed when team members display the following behaviour:

- ***High inquiry behaviour includes:***
  – seek confirming views.
  – ask leading questions.
  – discourage challenge.

- ***High advocacy behaviour includes:***
  – state conclusions.
  – give no examples.
  – does not explain own thinking.

- ***High inquiry AND high advocacy behaviour represents:***
  – explain own thinking and assumptions.
  – give examples and motivations.
  – seek others' views.
  – probe others' thinking.
  – encourage challenge to own views.

Research by Losada and Heaphy (2004: 747) indicates that high performing teams display a 50/50 balance between inquiry and advocacy behaviour which confirms the view that leaders of strategic conversations need to both open-up their thinking patterns to others and also allow participants to share their perspectives and insights on the matter under discussion.

## STRATEGIC CONVERSATION OPTIONS

The strategic conversation takes place in formal and informal settings. People exchange views informally when they meet by chance outside scheduled communication events, e.g. around the water cooler, in the coffee room and at home. This part of strategic conversations is difficult to influence, but greatly affects people's views. It happens spontaneously and helps people make sense of events and trends in the strategic landscape. The mental models that develop as a result then drive their action planning and action taking. This is part of the strategic sense-making activity for individuals and is mostly done in interpersonal or small group situations (Ungerer *et al*., 2007:313).

In most organisations however, people also come together through formal processes, systems and methods for the exchange of ideas. Here management intervenes by structuring the following situations:

- Strategic content and positioning workshops
- Strategic planning sessions
- Strategy reviews
- Budget setting and project reviews
- Efficiency improvement projects
- Strategy "deep-dives"
- White space reviews
- Work-based simulation workshops

These processes inform and form the audience's opinions, but are in turn formed and informed by the audience's reaction. To do this well, leadership must be aware of the information in the informal conversation. This ensures that the formal agenda addresses relevant issues, thus maximising its impact.

Strategic conversations can be planned as either a small team event (up to 12-15 participants) or as a large team event where up to 1000 participants are hosted. The following three design options are described to illustrate the variety of approaches (less formal to highly structured interventions) available to leaders depending on the nature of the strategic challenge and the type of work required to move the organisation to new strategic positions.

### Dialogue Circles

The word *dialogue* comes from the Greek words "dia" and "logos" which means meaning flowing through (Ellinor & Gerard, 1998:19). In a dialogue on strategic issues the intent is that meaning will emerged from each participant as a unique stock and flow of knowledge as well as through the interaction of the participants. This is in stark contrast to *debate* which means to beat down or even *discussion* meaning to break things up.

Dialogue is a conversation approach that centre on embracing diversity as positive force in organisations. A dialogue circle is structured on the conversation processes, principles and interaction approaches as described above in the previous section. This means the leader gathers with a group of 5 to 15 people (customers, frontline staff, regional representatives, middle managers, specialists from functional areas like marketing, HR, IT, other stakeholder or interest groups from the community etc.) in a hospitable space (preferably not a formal boardroom) to engage on matters of mutual interest. The group is arranged in a circle format to foster togetherness, eye-contact and intimacy. The agenda can take on many forms depending on the purpose of the meeting, but the intent is never to create a one-way communication event where the leader speaks most of the time and the other participants are just passive attendees. Dialogue circles operate on the principles of equality and respect for others and the two skills of advocacy and inquiry are important tools for the leader of the conversation to encourage full participation, insight development and strategic alignment. The process is primarily driven by a question(s) that matter for the participants and a free flow of interactions follow as participants contribute their perspectives around the focus question. Dialogue circles can vary in time from 45 minutes to one day sessions depending on the question topic.

The overall experiences of participants are very positive and they often make statements like "time flies amazingly fast when you listen and engage with others" and "it was very informative to hear other views on the issues we face". The difference between a conventional strategic meeting and a dialogue approach to strategic conversations is illustrated in figure 1. (Also see **Exhibit 1** for an example of the application of a dialogue circle approach in a financial services organisation.)

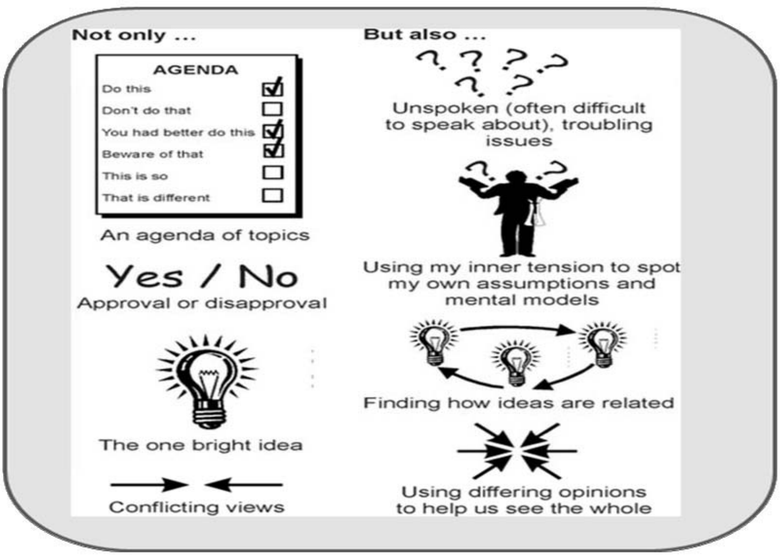



**Figure 1**: A dialogue approach to strategic conversations (based on a hand-out at a workshop with Juanita Brown – one of the originators of the World Café process, 1999).

**Exhibit 1: Applying a Dialogue circle approach to create strategic alignment in a specialist unit in a Bank.**

The HR team of a large financial services organisation in South Africa was wrestling with the challenge to co-ordinate their delivery on a national basis to internal partners. They have implemented a new HR operating model where the internal line leadership was empowered through technology to take a much more direct responsibility approach for the operational HR administration of their people. As a national organisation with representation in nine provinces the implementation of this strategic change posed quite a challenge for the HR team.

Apart from supporting the intended change with all the good practices associated with implementing this type of change (well documented operating manuals, change workshops, operational training, communication initiatives and a change plan), the leader responsible for HR services in the provinces decided to support the provincial HR leaders in a new way. Opportunities in the form of time and space for open dialogue about the progress (or not) made with the implementation of the new HR operating model were created by initiating a monthly face-to-face dialogue circle process (see above description on dialogue circles). These scheduled interactions of the HR leaders from the different provinces with their line leader and selected specialist head-office colleagues were not hosted on the business premises of the organisation as the tradition was with this type of meetings. To create a spirit of openness, fun, informality and fresh thinking these dialogues were conducted in the tranquil environment of the botanical gardens of Pretoria. The dialogue circle activity happened under the shade of an indigenous tree, all participants sitting on chairs in a circle, with the aroma of garden flowers around them.

After the introductory formalities were completed (welcome, context setting and ground rules) the line leader started the conversation by asking the participants to think about a question that, when it is answered, will make a big difference in their success to implement the new HR operating model. Typically several questions would be considered by the group, but one or two questions normally stand out. The group was then encouraged to engage on answering these questions from their individual and collective perspectives and experiences. This resulted in lively interactions and exchanges of viewpoints, inputs and ideas. As the dialogue progressed (3 to 4 hours) the team developed for themselves answers, insights and solutions which increased their level of understanding on the significant challenges they faced and possible avenues to take to improve current performance baselines.

Every time the team engaged in this form of conversation they reported amazement on the results they achieved to enlighten and inform themselves to tackle challenges. The role of the executive leader in this dialogue circle processes was to authorise the practice by making both time and resources available for the activity, but even more importantly, to be courageous by opening-up the conversations for divergent views by fostering open dialogue and transparency. The executive leader of the team restrained from giving answers, but focused on listening with enthusiasm and seeking connections between the various views to create a holistic picture of the situation. Team members showed high involvement by participating in the dialogue at different times; they listened and built on the ideas of others. When asked to reflect on the dialogue circle activities team members reported high practical value on ideas to assist their change implementation initiatives as well as enjoyment to be part of a collective learning experience.

These monthly high engagement work sessions continued to be scheduled during the implementation phase of the HR operating model change process and participants indicated that it was a positive method to build capacity and momentum to execute the change intent in an efficient way.

## The World Café approach

The world café approach (Brown, 2002; Brown &Isaacs, 2005) is about creating an environment that feels like a café or a tavern, a porch swing or a kitchen table — a place where people feel comfortable to talk in small intimate groups about topics of interest, where they are able to explore and debate possibilities, often possibilities about the best they can possibly be. In order to create a café you need small tables, (to accommodate four to six people), chairs, large sheets of paper for tablecloths along with flowers, candles, marking pens and refreshments for each table. To create a hospitable atmosphere, music is played and there are perhaps welcoming signs. The leader welcomes everyone and invites them to find a seat at one of the tables. S/he then suggests the topic, always a question that is calculated to matter, and then explains that after a set period of time (usually 20-30 minutes) people will be asked to bring the conversation to a close and move to new tables.

In the case of a strategy café the question for discussion could be any of the following or others:

- What happened in our past that is useful to carry forward?

- What excites you about our future? What is the best we could become?
- What are the options and choices facing us now? Which ones should we choose and why?
- What market spaces are available for us? How will we capture this space?
- What could we as a great company also be?

As people talk at their tables they record ideas, insights and questions that emerge by writing about or drawing them on the paper tablecloth. After the allocated time, the organiser requests participants to choose a host for each table. The host is requested to remain at the table for the next session. Other participants may now get up and move to new tables. After everyone is seated, the host welcomes the new group, tells them what has been discussed and brings them up to date with the key ideas and questions that emerged from the last conversation of the previous group. The new participants are encouraged to link ideas and to build onto previous points. This ensures the cross-pollination of ideas and by the end of the second round all conversation clusters will reflects insights from previous conversations. In the third round participants can return to their original table to synthesise their insights or a new question can be explored to deepen the understanding. After several rounds of conversation each table is given an opportunity to share their discoveries and conclusions to the whole group in a town-hall meeting style. This format can be varied to suit different situations and groups.

Looking at what might happen, what needs to be addressed, feeling connected to the issues and to each other is an integral part of change. The café approach to hosting strategic conversations provides this experience. (See **Exhibit 2** for a description of a leadership-led strategic development process in a non-profit organisation using conversational approaches.)

**Exhibit 2: Transformation in a mainline church in South Africa using conversational techniques.**
During 1998 the leadership of the Southern Transvaal region (now the Highveld region) of the Dutch Reform Church of South Africa expressed a need for a new strategic direction in the way the regional synod operated in order to involve more people in the day-to-day regional running of the affairs of the church.

The first intervention was a strategy and teambuilding session for all the leaders of teams tasked with the execution of Synod decisions between sittings (every four years). Many of these "specialisations" had limited contact with each other, with the result that activities degenerated into (often competing) fiefdoms, more often driven by the special interests of the leader than the strategic direction set by the Synod. Over many years this created a situation where even Synod sessions were overshadowed by personalities and personal agendas (often degenerating into vendettas and splits along party political lines). Meeting each other as human beings (rather than representatives of some special taskforce or church-political point of view) had all the positive results one can expect and set the scene for a very different kind of strategy session.

After overcoming initial posturing (playing the old power games) participants in the strategy session managed more than just finding each other as a faith community – they found a new calling, a new vision for the Synod of the Southern Transvaal:

| | |
|---|---|
| *Heer, U wat die sewe sterre in U hande hou,* | *Lord, Who hold the seven stars in Your hands* |
| *maak Suid-Transvaal se gemeentes saam* | *make Southern Transvaal's congregations shine together* |
| *soos helder sterre in die donker van ons tyd,* | *like bright stars for the darkness of our time* |
| *sodat elke mens en alles in die heelal sal uitroep:* | *so that all people and the whole universe will shout:* |
| *"Jesus is al wat vir ons tel;* | *"Jesus is all that matters;* |
| *Christus is eerste in alles en almal!"* | *Christ is first in everything and everybody!"* |
| *Vader, maak Suid-Transvaal se gemeentes* | *Father, make Southern Transvaal's congregations* |
| *saam klei in u hand -* | *blend like clay in your hand -* |
| *die hand wat kan waar ons nie kan nie -* | *the hand that can where we cannot -* |
| *sodat ons deur u Gees die wêreld in nood* | *to enable us, by your Spirit, to serve the world* |
| *feestelik met u liefde dien.* | *with the feast of your love* |

They translated this Vision into the following Mission:

| | |
|---|---|
| Om biddend saam God se wil te soek, | To seek God's will together in prayer, |
| sy Naam te eer en sy ryk te dien. | to honour his Name and serve his kingdom |
| Om die gemeentes in Suid-Transvaal saam te snoer | To connect the congregations of Southern Transvaal |
| om die visie begeesterd te maak werk. | together, inspired to make our vision work. |
| Om uit te reik na mekaar en verhoudings as | To reach out to each other and to build relationships |
| vierende geloofsgemeenskap te bou. | as a festive faith community. |
| Om die boodskap van verlossing | To preach the message of salvation |
| aan die wêreld te verkondig | to the world. |
| Om die gemeenskappe en omgewing | To serve our communities and the environment |
| liefdevol te dien. | with love. |

The above outcomes were achieved through intense dialogue between participants within a context of respect for and a willingness to listen to each other in a new way. The main approach for this first work session was to create a hospitable space for participants to connect to each other. Energised by the new vision they were also able to develop (over the next year) a new structure for Synodal activities and committees.

The next Synod meeting had to approve the new vision, mission and structure suggested by the leadership. Fearful of old, counter-productive behaviour – where divisive debate won out over enlivening and enlightening conversation – they decided to use a more conversational method for discussions by participants – the so-called Large Group Interactive Event (discussed in next section). This allowed the collective wisdom of participants to emerge and guided the organic formation of consensus, leading to decisions that "stuck" and therefore got actioned.

This proved to be such a success with participants that other regional Synods gradually adopted the methodology of a more interactive and participative approach to regional church leader meetings until the National Synod of the Dutch Reform Church eventually adopted this approach for their meeting in 2004.

Their appetite being wetted, the Synod of Southern Transvaal (now the Highveld Synod) continued to experiment with different dialogue techniques – Dialogue Circles, the World Café, alternative visioning techniques, Future Backwards, etc. – to develop a set of values and to continue refining their structure and its activities to serve congregations in order to fulfil their motto: "From congregations; For congregations".

The following quote from an article they published on 21 August 2007 on their website[1] illustrates their commitment to conversation:
"The conversation about the church today is changing. This conversation is introducing a way of thinking about the church that is quite different ... one that seeks to probe more deeply key questions about the church. It is a discussion that is not being driven primarily by changes taking place in our cultural context, although these are attended to as being important. And it is a discussion that seeks to go beyond just focusing on purpose, strategies, or recovering early church practices. This different conversation is being shaped by a biblical and theological imagination for understanding the very nature of the church. The key premise is that understanding *the nature* of the church is foundational for being able to clarify the purpose of the church, and for developing any strategies related to that purpose. And understanding the nature of the church is also seen as being foundational for discerning how to address changing cultural contexts. This represents a change ... in the conversation about the church ..."

Continuing to experiment with new conversational technique(s) as a leadership group, the Highveld Synod used those techniques that held promise (after adapting them to suit the purposes of the church). During their last synod they used Appreciative Inquiry and Storytelling as techniques to structure discussions. As a result, participants not only took decisions back home, but also some techniques they could apply in their day-to-day leadership of congregations.

During the entire process the challenge for the process facilitators, Marius Ungerer and Johan Herholdt, was to adapt theoretical and business models to suit the needs of the church. One central difference is that congregations are autonomous while the synod can only influence and guide – in other words, a very different model of leadership than the facilitators (coming from a business environment) were used to. Reticulating the conversational technique through the biblical (and Calvinist) doctrine forced us to think very carefully about the choice of technique and the "conversational space" created by it. Learning from and with our clients opened up a new conversation for us, often leading to interesting deviations from and changes to the "conversational recipes" we were used to.
Another interesting change was being (often deeply) touched by the content of conversations in addition to just facilitating "the process". Rather than it being a distraction we experienced it as a way of connecting to "the business" of our client in a much more authentic and (for us at least) satisfying way. In this regard we have to mention the lasting impressions made on our lives by many participants, but especially the following people:
Willie Goosen – for teaching us that "vision" was firstly and originally a biblical concept;
Johann Symington – for the chutzpah to use business techniques, then helping us to discover the spiritual roots of conversation and the necessity of love; and Nelus Niemandt – for doctrinal clarity and the courage to apply (initially outlandish) techniques.

Note:1. http://www.kerkweb.org.za/ho%C3%ABveld/artikel.asp?id=193&katid=27&subid=28&posisie=2&sinid=9 (Accessed 4/2/2009)

## Large Group Interactive Events (LGIE)

The change imperatives that impact on organisations are greater than ever and the potential effect is bigger than ever. Business leaders are confronted with intense competition, increased globalisation, fast technology development and implementation as well as an ever-increasing pressure to reduce cost and increase quality, all at the same time. These types of pressures are not limited to parts of the organisation, but have an impact on the total organisation. Organisational leadership have to respond in a new way to deal with all these pressures. Large group change processes provide an approach for getting the change message to the total organisation by enhancing everyone's understanding of the current situation and the context (Bunker & Alban, 1992:477)

Large group interactive processes aim to assist organisations to use the knowledge, wisdom and heart of all their people to meet the challenges of a changing world (Dannemiller, James and Tolchinsky, 1999: 205). They consist of a series of small and/or large groups interactions where the principles of action learning, local knowledge creation and systems thinking are used to enable whole system transformation. A large group interactive event brings together all the people of an organisation (up to a thousand at a time) in small group settings (eight to ten per table) in the same physical area to explore organisational issues and to develop appropriate responses to these challenges. A large group interactive event is the result of a series of interactive processes with the leadership of the organisation and design team members who are representatives from the different organisation parts. Large group interactive events are used by organisations to boost system-wide transformation efforts by creating a shared experience and framework in respect of:

- implementation of strategy.
- alignment of people through the creation of shared meaning around critical ideas, processes and practices.
- change imperatives relevant for the total organisation.
- expectations from key stakeholders (customers, shareholders, employees, community, etc.).
- culture and behavioural standards of the organisation.
- any other organisational performance issues as identified. (Examples are organisation design, mergers and acquisitions, quality, customer service or culture change.)

The four key building blocks of a large group interactive change process are the leadership team of the organisation, a representative design team, a large group interactive event that mobilises organisation members and a follow-through team (see Figure 2).

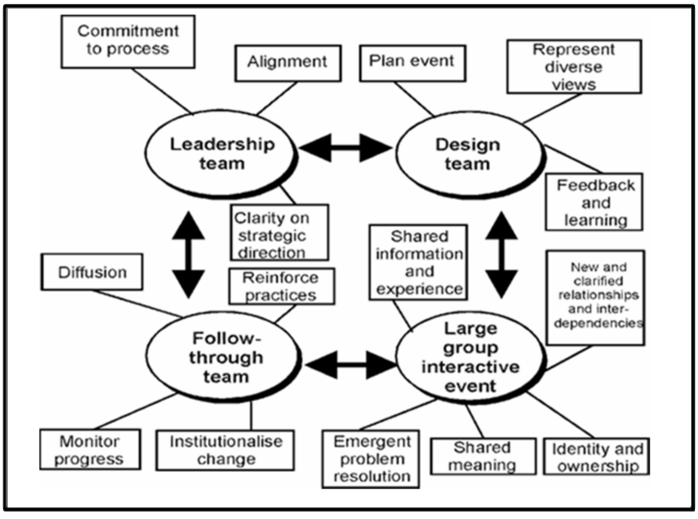



**Figure 2:** Key elements of a large group interactive change process (based on Jacobs, 1994).

The leadership team enables the strategic process by providing and allocating resources as and when needed. The process also empowers the leadership team to share their sense of direction with all the people of the organisation. During the event the leadership team models the way by setting an example for others to follow. They build collaboration, trust, openness, shared understanding and alignment through information sharing, feedback and participation.

The design team is a cross-functional, cross-level team which is a microcosm of the total organisation and/or those who will participate at the actual change event. The design team's task is to draft the design of the change event in cooperation with the leadership team.

Large group interactive events are highly structured and organised in the greatest detail. The logistical arrangements for an event are done by a support team. The support team does all the logistical preparation needed for the event (supplies, equipment, banners, etc.). They support the flow of data and data management during the event. Their role can be compared to that of a stage crew during a live performance. They support the event by distributing handouts on a real-time basis, move flipcharts, hold microphones during report-outs and serve the participants at the tables to ensure a smooth unfolding of the planned interventions. The support team's main focus is on the process during the event which ensures that small mistakes are not amplified into big interruptions of the process. A LGIE typically happens over a two or three day period to guide participants through the change stages of dissatisfaction, visioning and first-steps.

Follow-through activities vary considerably from organisation to organisation just like actual large group events. Generally, members of the design team and members from the leadership team are contracted to perform specific implementation follow-through actions and initiatives to ensure a continuation and implementation of the decisions agreed upon during a LGIE.

A key feature of large group interactive events is the involvement of at least a critical mass of, if not all, the people in an entire organisation. According to Jacobs (1994:25) this widespread involvement serves three purposes:

- A data-rich, complex, clear, composite picture of the current organisation realities can be constructed by integrating and weaving the many perspectives available in the situation on a real-time basis.
- New, different and shared insights emerge from this more informed view. This creates the basis for a new partnership, collaboration and co-operation in unexpected ways.
- All stakeholders understand, accept and can start to use these broad, whole-picture views in deciding how they want and need to do business in the future. A shared experience and baseline creates the fuel and energy for localised execution, taking into account the "bigger picture". A total organisation mindset creates the context for successful local performance.

Large group interactive processes help to increase the value of the intellectual capital in the organisation by connecting more of the organisation to itself. This results in unexpected new insights based on the wealth of knowledge available, the processes applied to disseminate the information to all participants in real time and the positive contagion effect of community. People at a large group event become open to be disturbed by the process and content of the event. This creates individual and collective capacity in a system to move to new positions that make sense to themselves and benefit the total organisation. Many competitors have the same broad strategy, but the successful ones are those who can move from plans to implementation, those who can mobilise a critical mass of the people in the firm to work collectively in a synchronised way to achieve mutual goals. Large group interactive processes enable implementation as a competitive advantage in a fast and effective way (Ungerer *et al*., 2007: 297). (See **Exhibit 3** for a description of a LGIE application in Absa, one of the major banks in South Africa).

**Exhibit 3: Using Large Group Interactive Events (LGIE) to facilitate a post-merger integration.**
A LGIE approach was followed in October 1997 to facilitate the post-merger activities of United Bank as part of the formation of the Absa Group. During this period United Bank had about 2000 branch employees in the Gauteng Province of South Africa. The executive team of this province had the challenge to transform the branches from a building society offering to a fully integrated banking institution whilst maintaining profitable growth in the province with the highest market potential.

The purpose statement for this LGIE was "To drive the company into the next century by mobilising the energies of individuals in our organisation, promoting a common vision and instilling an insatiable drive for achievement"; with a theme for the event of "We'll Win". The event happened over a period of three sessions of three days each (in total nine days), allowing each branch employee to attend one of the events (~700 participants at each event) at a rate of a third of the employees at a branch at a time. This permits the participation and complete involvement by all the members of the target organisation from all levels, functions and branches in the Gauteng region. Before the event the leadership team and a design team (representatives from the branches) worked with consultants to design a process where each event would create shared reference points for participants (new vision, change rationale, current realities).

The design also made provision for the cumulative building on the ideas of participants to enable a positive flow of information from one session to another. The focus of the first event was primarily on the new vision and values of United. Event two completed the United value's and worked on internal relationships and partnerships. The last event focused on partnerships, business goals and follow-up processes. All three events had a focus on personal change and the improvement of business practices. Leadership played a crucial role during the events and gave presentations and guidance to create unity of understanding around key business issues and challenges.

The interactions at the different events produced six clear focus-areas or goals for the business to concentrate their future efforts on, namely service quality, competent people, sales routines, risk management, information management and financial performance. Every individual who attended the LGIE went away with a clear understanding on first steps required to change the performance on the collectively identified goals. The focal point of the events was to create unity towards a common goal. Each individual began to shift their thinking from asking "How?" and "Why" to "What can I do?" In the end it's about the entire organisation echoing with one voice "We were part of the United community, we made the difference".

The participants reported a very positive experience of the events. Words like "we are very excited about United's future"; "we are proud to be associated with United" and "we have committed ourselves to new goals" were common amongst participants. It was evident to participants that a transformation was occurring before their eyes during the events.

A follow-up work group was established after the events to assist with the execution of the decisions made at the events. The follow-through team again consists of a variety of individuals representing the voices in United branches in Gauteng. This team cooperate with the leadership team to create clarity on strategic goals, measurements, targets and key initiatives. A communication approach was also developed to ensure ongoing information flows and support.

The leadership team of United in Gauteng confirmed that the LGIE approach was instrumental in accelerating the achievement of very high aspirational targets and to mobilise energy in a fast and efficient way.

## CONCLUSIONS

The strategic conversation connects individuals and teams. To encourage people to venture into new spaces, leaders have to create a psychologically safe environment in which error becomes a positive investment in the future rather than something that deserves punishment. Leaders who accept strategic conversations as a high leverage available to management can utilise it in creative ways to overcome the traditional top-down enforcement of the notion of a "one best strategy". They realise that making people think (and making that thinking visible through small and large group processes) is far more important than enforcing a strategy that will not be implemented because nobody has bought into it.

Command and control strategies might give short-term movement, but for long-term sustainability we need to talk things into the open and into shared conviction. Leaders who take up their role as a host of strategic conversations where meaning is created collectively and new insights emerged as the result of engagement is part of an exciting new movement to unlock the sustainable competitiveness in organisations.

# REFERENCES

Brown, J. (1999). *Workshop on a World Café approach*. Pegasus Conference on Systems Thinking, USA, Atlanta.

Brown, J. (2002). *The World Café: A Resource guide for hosting conversations that matter*. Waltham, MA.: Pegasus Communications.

Brown, J. and Isaacs, D. (2005). *The World Café: Shaping our Futures through Conversations that Matter.* San Francisco: Berrett-Koehler.

Bunker, B.B. and Alban, B. (1992). The Large Group Intervention – A New Social Innovation? *The Journal of Applied Behaviour Science*, December, 28 (4): 473-479.

Dannemiller, K.D., James, S.L. and Tolchinsky, P.D. in Holman and Devane (eds), (1999). *Whole Scale Change*. San Francisco: Bennett-Koehler.

Ellinor, L and Gerard, G. (1998). *Dialogue: Rediscover the transforming power of conversation,* New York: Wiley.

Gratton, L. (2000). *Living Strategy: Putting people at the heart of corporate purpose.* London: Pearson.

Hamel, G. (1996). Strategy as Revolution. *Harvard Business Review*, July-August: 69-82.

Jacobs, R.W. (1994). *Real Time Strategic Change*. San Francisco: Berrett-Koehler.

Kaplan, K. and Bienhocker, E.D. (2003). The real Value of Strategic Planning. *MIT Sloan Management Review,* Winter: 71-76.

Losada, M. and Heaphy, E. (2004). The Role of Positivity and Connectivity in the Performance of Business Teams. *The American Behavioral Scientist,* 47 (6): 740-765.

Nel, C. and Beudeker, N. (2009). *(R)Evolution: How to create a high performance organisation*, Cape Town, South Africa: Village of Leaders Products.

Porter, M.E. (1996). What is Strategy? *Harvard Business Review*, 74 (6): 61-78.

Ungerer, M., Pretorius, M. and Herholdt, J. (2007). *Viable Business Strategies: A Systemic, People-centric Approach*, Randburg, South Africa: Knowres Publishing.

Wheatley, M. J. (1994). *Leadership and the New Science*. San Francisco: Berret-Koehler.

Wheatley, M.J. & Kellner-Rogers, M. (1996). Self organisation: The irresistible future of organising. *Strategy and Leadership*, July-August: 18-24.

Wheatley, M.J. & Kellner-Rogers, M. (1998). Bringing life to organisational change. *Journal of Strategic Performance Management*, April-May: 5-13.

# ACNOWLEDGEMENT

Johan Herholdt is a South African-based organisational development practitioner. He uses individual and team coaching, strategy development and implementation, and conversational techniques to enable an organisational culture where strategy (or the promise to shareholders) gets implemented. His assistance and influence in articulating and describing some of the ideas related to strategic conversations as reflected in this article are recognised with appreciation. These ideas are reflected in the book Viable Business Strategies: A Systemic People-centric Approach, chapter 7 of which Johan is a co-author.

# THE RELATIONSHIP BETWEEN THE STRATEGIC INFLUENCING SKILL AND INTRA-ORGANIZATION COMMUNICATION IN LEADERSHIP AND A CHAIN STORE APPLICATION

**Mehmet Tikici**
**Selma Karatepe**
**Mehmet Deniz**
**Sinem Güravşar Gökçe**
**Inonu University, Turkey**

## ABSTRACT

*Strategic leadership means; composing strategies by analyzing internal and external environment correctly, executing correct strategies at correct time, appraising it and presenting the best leadership behavior according to the situation (Altınkurt, 2007: 4-12).*

*Strategic leaders are responsible for creating the future of their organizations. The most important characteristic of strategic leaders is strategic influencing (Grandstaff and Sorenson, 2009: 270-272). Strategic leader plays a distinctive role in development of organizations by the help of communication, which is the most important tool of strategic influencing. This assumption forms the starting point of this study. In the scope of this study, we tried to find out whether there is any relationship between intra-organizational communication and strategic influencing skills of managers working in chain stores or not, by statistical methods.*
***Keywords:*** *Strategic Leadership, Strategic Influencing, Intra-Organizational Communication.*

## INTRODUCTION

Strategic leaders should have the “strategic influencing skill”, in addition to the other leadership skills to be effective because the responsible strategic leaders have to make an intensive effort to inform people from different level in the communication channel. This necessity increases the importance of strategic influencing skill of the leaders because information which is defined as “the link between the human and the object” changes place from transmitter to receiver as a result of the process called “communication”. Thus, it becomes an important factor for improvement of individuals and organizations. Although, leadership and communication have a great importance for all enterprises, they have a special meaning for the chain stores because a problem caused by the leadership approach or intra-organizational communication style in a single office, factory or store would affect only that company but in chain stores, any problems in one of the stores would affect the other stores of that company too.

In this case, the question “Is there any relationship between intra-organizational communication and strategic influencing skills of managers working in chain stores, which are in the scope of this study?” forms the problem sentence of this research. Accordingly, the aim of this study is “to determine the intra-organizational communication level and strategic influencing skills of managers working in the chain stores in Malatya, and to discover the relationship between these two variables”.

The conceptual scope of this study is limited with “the strategic influencing skill and intra-organizational communication level of managers”. The scope of application is limited with a chain store, named Esenlik, in Malatya city. This company has 11 stores with approximately 350 employees. The originality of this research arises from the testing of the relationship between two fundamental variables that are defined in conceptual part by statistical methods.

# LITERATURE REVIEW

## Strategic Leadership

Nowadays, due to the globalization, the problem of companies about "integrating with the global market" increases its importance gradually. Substituting national economic values with global values creates risks and hazards as well as opportunities (Dulupçu, 2001:3). Firms have to develop strategies suitable to the route determined by globalization to maintain their competition superiority. The responsibility of developing such strategies belongs to the top managers, who are at the top of the hierarchy and are responsible for the entire organization (Hatipoğlu, 1979:249). Decisions of these top managers bear so much importance since they have a determining function for the survival of the firms. These managers, are the people who directly affect the activities of the firm with all official and symbolic power and performance by the decisions they made (Hout and Carter, 1998:84).

The factors which transform managers into effective and successful leaders are discussed in leadership theories. *Characteristics theory*, examines successful leadership from the aspect of the "leader's characteristics" (Akat et. al., 1994:326). Another leadership theory, *behavioral leadership theory* argues that the factor that makes leaders successful and effective is "their behaviors during the leadership process" (Koçel, 1999:332). According to a third theory, *situational leadership theory,* "leader's personality with the structural properties of the environment determines the leader's behavior" (Koçel, 1999:338). Leadership style is very important for achieving the organizational goals and since leadership style is determinant many researches had been done in this subject. For example, in a research leadership is divided into four main groups: laissez faire, management-by-exception, contingency reward and transformational leadership styles (Kennedy and Anderson, 2005: 115-135). In another research by Lewin, White and Lipit leadership is examined in three main groups as autocratic, democratic and laissez-faire (Vugt, Jepson, Hart, Cremer, 2004: s.1-13).

Parallel to the change in information society, the traits and behaviors that make the transition from top managers to effective leaders are going through a fast transformation. In this process there has been an increasing need for leaders with the ability of envisioning the future and creating the necessary strategic management approach. Strategic management, which is formed by strategic leaders maintaining the improvement of their organization and influencing their followers, has a wider scope than the routine managerial issues. Strategic management means planning strategies by the help of research, study, assessment and selection activities, taking all of the precautions for the implementation of this strategy, and controlling these before execution (Eren, 2000:18). Leaders who are capable to fulfill these requirements are called "strategic leaders". Strategic leader is the person who is responsible for the management process of determining, implementing and assessing the strategies of any organization or any part of a strategic organization (Dinçer, 2003: 339). Strategic leader can also be defined as the person who thinks and predicts the future, builds the organizational flexibility for necessary change and has the capability of empowering others to make strategic change possible (Hitt et. al., 1999:439). So, strategic leadership requires the ability to know and understand the work environment. Also it requires being objective, ability to move away from the chaos of daily or routine events, and ability to see the bigger picture (CMOE, www.cmoe.com).

Ability to manage human resource is one of the most crucial skills of a strategic leader. Strategic leadership enhances an organization's sustainable competitive advantage through not only his strategy but also his vision, values, culture, organizational climate, leadership, structure, and systems (Beatty & Hughes, 2005a:3). To appreciate the structure and importance of strategic leadership will help to distinguish it from operational leadership. Strong operational leaders are result-oriented and they are skillful about allocating the necessary resources to the necessary jobs. Most senior managers provide progress to their organizations since they have strong operational skills (Beatty &Hughes, 2005a:3).

One of the most important success factors of strategic leaders is their "thrust levels". At a minimum there are three such relationships, and each can be qualitatively rated along a continuum ranging from "Fully Trusted" as the ideal to "Not Trustworthy" (Snider, 2008:256–277). These are the profession's relationship to the client, to the other organization's leaders and subordinates. Other traits of strategic leader which is a very complicated and critical style of leadership are as follows (Hitt et. al. 1999:440-449):

1. Defining strategic direction of the firm.
2. Taking advantage of firm's core competencies.
3. Developing firm's current human sources.

4. Supporting of an effective organizational culture.
5. Sticking to the importance of the ethical practices.
6. Balancing the organizational control.
7. Defining a clear vision and focusing to all of the activities in accordance with this direction (www.insankaynakları. com).

Strategic leaders must have three more skills to be effective in addition to the leadership skills given above. These three skills are; strategic thinking, strategic acting and strategic influencing. Strategic thinking, involves what the organization's vision is and what it should be. Strategic thinking offers new ways of learning the threats and opportunities by examining the internal and external environment in terms of trends, patterns, and other factors that may influence the business now and in the future. Strategic thinking deals with crucial issues rather than ordinary or unimportant ones. Since it is not a science it can not be taught. It is both abstract and concrete. Strategic thinking should be transformed into strategic plan and requires synthesis besides analysis (Adair, 2005:44). Strategic thinking is a process which is composed of four basic steps (www.cd.org; Hughes & Beatty, 2005:53-67). These are scanning, visioning, reframing and making common sense and it includes three thinking level in general: facts, behaviors and systematic structure. As the thinking level increases, understanding, explanation and learning becomes deeper (Dalay et. al., 2002:10). According to Rhinesmith, the most important level of thinking is forming a global thinking structure (Rhinesmith, 2000:38).

Strategic acting is also very important for strategic leadership because there are lots of difficulties in transforming strategic thinking into action. These difficulties are not having clear strategic focus, not matching tactics with strategy and not integrating short-term objectives with long term ones. To overcome these difficulties, it is needed to make supportive connections with the necessary power sources, form collaboration and commitment with desire about turning vision into reality (Keçecioğlu, 2003:74).

## Strategic Influencing

Influence and persuasion are just some other words for selling. You may think that good ideas will sell themselves, but life is not like that. Everyone resists to change. Anything new is certain to be treated with suspicion (Armstrong, 2004:104). Based on the literature about influencing, 15 prominent tactics were found. Previous researches have typically categorized influence tactics as soft, neutral, and hard. Using this classification, other tactics can be grouped accordingly. Soft tactics would thus include avoidance, coalition, crying, having a tantrum, sociality, inspirational appeals, preparing groundwork for the future success, personal appeals, and soft selling. Neutral tactics involve consultation, exchange, and rational persuasion. Finally, hard tactics include being directive, and using legitimating tactics, pressure, and rewards (Cocivera & Earn, www.open.uogeuelph.ca).

If the strategic leader can show the capability of persuasion or affect the subordinates and/or strategy team, then clarity of vision, commitment and synergy would flourish among the organization. Strategic influencing provides commitment of organization towards the strategic direction and learning. Leaders would have difficulties about setting a plan, getting others on board, and implementing a strategy in a complex and chaotic environment. Thus, leading them by strategic influencing is important. Strategic leaders often know the path to pursue and might be decisive and confident enough to walk that path despite the uncertainty, but enlisting others in the effort can be much more difficult (Hughes & Beatty, 2005b:123).

Effectiveness of the leader relies on the responsibility that the leader takes about the group's happiness (Harari, 1996:104). Thus, it is known that leaders share ideas and objectives with their followers rather than dictating them (Holley, 1996:94). Ones who want to be a strategic leader should develop and sustain an organizational system and culture. Renowned ideologue Lao Tzu states that the best leaders are the ones who respect others, share the success and the ones whose subordinates don't afraid of him (www.stratejiyönetim.com). Strategic leaders must exercise strategic influence up toward more senior executives, peers, down to lower level and outside the organization (Hughes & Beatty, 2005b:129).

## Intra-Organization Communication

Communication is basically defined as "shared usage of information" (Işık, 2002:13), and organizational communication process refers to the communication style between top managers and their employees, medium level managers and other employees in an organization (Grunig, 2005: 15).

Intra-organizational communication is a complicated subject, which progresses in many fields with an increasing importance as a new academic discipline after 90s (Visser, 2000: 231-252). Before the modern management approach, especially in small organizations people were usually communicating face to face and informally, but as the organizations get larger intra-organizational communication became more complex and have a great importance for organizational success. Thus, in one hand the effects of organization type to the intra-organizational communication and on the other hand the usage of new communication technologies for the organizational improvement is researched.

Drenth defines communication as "sending and receiving of messages by means of symbols" and see organizational communication as "a key element of organizational climate". According to Myers and Myers organizational communication is "the central binding force that permits coordination among people and thus allows for organized behavior" (Baker, 2007).

When the related literature is examined, it is seen that there are many studies showing that communication forms the core of organizations. It is effective on intra-organization as well as among organizations. The information and innovation increase the competitive power of organizations and thus communication technology and intra-organization communication network becomes an essential necessity for the structure and strategy of organizations (Paulraj et al., 2008: 56). On the other hand Rogers and Rogers argue that "the behavior of individuals in organizations is best understood from a communication point of view". The study of organizational communication recognizes that "communication in organizations goes far beyond training managers to be effective speakers" (Baker, 2007). It is known that intra-organizational communication has a central role in processes like authority, leadership, and decision making (Bratton, 1999: 307). It is accepted that the progress of organizations effectively is parallel to the effective organizational communication, and the organizational effectiveness which is a product of qualitative and quantitative outputs is evaluated due to the quality of intra-organizational communication (Kreps, 1990: 282). Thus, important connections are built between communication and managerial effectiveness in this last century (Shocley and Zalabak, 1991: 7).

The manager and the employees, who are the two sides of organizational communication, have a great importance for the intra-organizational communication but since the manager is in the "decision maker" position, it is assumed that the leader has more responsibility for effective communication (Tortop et. al. 2007: 101). Thus, the leaders should take the following basic principles into account while managing the intra-organizational communication (McNamara, 2007):

- Giving full support to the intra-organizational communication for the future of the organizations.
- Preparing groundwork for the effective communication in organizations including basic skills in listening, speaking, questioning and sharing feedback.
- Giving importance to sound meeting management in organizations
- Ensuring the sharing of responsibility when a problem occurs in communication.

In organizational management process, intra-organizational communication which is expected to develop in accordance with these principles, would act like a bridge between the organization and employee (Katz and Kahn, 1977: 263) and connects leader to the employee and vice versa. The main objective of communication as a system in an organization is to put the disconnected and messy relations in order and balance the organizational and individual objectives (Karatepe, 2005: 64). It is important for the employees to know what the leader expects from them and it is important for the leader to know the thoughts of employees as well. Because the employees would like to know the activities in other departments and outside the organization related to their work (Hodgetts, 1997: 274). Managers having strategic leadership traits have a supportive structure for the studies on building, organizing and operating the necessary communication network.

Researches show that the uncertainty due to the lack of information is the most important factor that causes an environment suitable for rumor and makes the employees unsuccessful at their works. Due to the lack of intra-organizational communication skills, employees might have negative feelings about the organization. That might cause a negative impact on organizational effectiveness as well (Hegeman, 1995: 52). Recent researches show that the reason for this problem is, the lack of active listening, speaking and communication skills of traditional managers, showing the lack of strategic leadership skills. Especially in application, dictating the commands of managers' by preventing the employees from participating causes interruptions in intra-organizational communication. The only way to avoid this is to make intra-organizational communication sufficient which is a broad process starting with informing employees and continues with taking the employees' suggestions into account. The effectiveness of the communication process contributes to the survival of the organization and achievement of objectives (Erdem, 2009: 133). The strategic leader, who succeeds these, is the leader that shares his/her knowledge, feelings and thoughts. Thus, the strategic leader (Erciş, 2002: 457- 458):

- Shares his/her perceptions, thoughts and appraisals within the organization,
- Shares the strong and weak sides of sociological, psychological and economical structure of the organization,
- Defines the problems which are the purposes of unsuccessfulness,
- Shares his/her projects within the organization.

In accordance with these principles, "intra-organizational communication" which is a strategic skill, can be used for increasing the organizational commitment of employees. It spreads out to a broad spectrum including the concepts of strategic leadership applications such as leading, vision, influencing, acceptance and collaboration.

# METHODS

The scope of application of this research is limited to a chain store, named Esenlik, in Malatya city. This company has 11 stores with approximately 350 employees. It was studied on samples due to the cost and time purposes. The questionnaires were applied to 110 people who were selected by simple random sampling method and valid 102 of these questionnaires were evaluated. The data is obtained by the questionnaires, which were designed according to 5 points Likert scale. The seven questions out of twenty three questions were related to demographic variables, seven of them were related to strategic influencing skill and nine of them were related to intra-organizational communication. The questions about strategic leadership were prepared by using the book "Becoming Strategic Leader" (Beatty and Hughes, 2005b) and the ones about intra-organizational communication were prepared by using the study named "Effects of Management Communication, Opportunity for Learning, and Work Schedule Flexibility on Organizational Commitment" (Butts, Dejoy and Wilson, 2006). These questionnaires were filled by trained people by face to face interviews. Data was evaluated by the help of reliability analysis, frequency analysis, and canonical correlation analysis by using "SPSS (Statistical Packages for Social Sciences) 12.0 for Windows". The results are presented through tables in the next section.

# FINDINGS and CONCLUSION

## Reliability Analysis

Reliability analysis is performed to show the consistency of all questions among themselves and to measure the formation which is handled (Özdamar, 2002: 662). Although there are many methods of analyzing reliability, Crombach Alpha coefficient is used in this study. Crombach Alpha is a coefficient, which reflects the general reliability structure, since its statistical fundamentals are consistent and it takes all of the questions into account (Özdamar, 2002: 663). Crombach Alpha coefficient is evaluated as: not reliable in 0-0,4 range, low reliability in 0,4-0,6 range, considerably reliable in 0,6-0,8 range and high reliability in 0,8-1,0 range (Alpar, 2003: 382).

As a result of reliability analysis of the questionnaire of this research, the Crombach Alpha coefficient was found as 96.61 % (see Table 1). This percentage shows that the questions have high reliability.

**Table 1:** Reliability Analysis

| Crombach Alpha According to the Standardized Questions | Number of Questions |
|---|---|
| %96.61 | 23 |

## Frequency Analysis

The frequency distribution of demographic variables is given in Table 2 and the frequency distribution of the variables strategic influencing skill and intra-organizational communication is given in Table 3.

**Table 2:** Descriptive Statistics For Demographic Characteristic of Respondent Sample

| | N | % | | N | % |
|---|---|---|---|---|---|
| **1.Role in Company** | | | **4.Sex** | | |
| Supervisor | 18 | 17,6 | Female | 4 | 3,9 |
| Personel | 84 | 82,4 | Male | 98 | 96,1 |
| Total | 102 | 100,0 | Total | 102 | 100,0 |
| **2.Years with Company** | | | **5.Marital Status** | | |
| 0–5 | 46 | 45,1 | Single | 18 | 17,6 |
| 6–10 | 27 | 26,5 | Married | 84 | 82,4 |
| 11+ | 29 | 28,4 | Total | 102 | 100,0 |
| Total | 102 | 100,0 | **6.Education** | | |
| **3. Age** | | | Elementary | 25 | 24,6 |
| 20–25 | 6 | 8,8 | High | 73 | 71,6 |
| 26–30 | 31 | 30,4 | University | 4 | 3,9 |
| 31–35 | 32 | 31,4 | Total | 102 | 100,0 |
| 36–40 | 24 | 23,5 | | | |
| 41 and + | 9 | 8,8 | | | |
| Total | 102 | 100,0 | | | |

It is seen that almost half of the participants' experience in the company is less than five years. On the other hand the employees, who are working more than eleven years, take the second place. According to this distribution, when the age of the company is also taken into account, we can say that the employees have enough experience. In addition to this, it is seen that most of the employees are between 26-35 years old, which means that the average age is low.

Another point that draws attention is, most of the employees are male. They were mostly graduated from high school and very low percentage was graduated from university. Thus, it can be commented that the education level is not very high.

**Table 3:** Descriptive Statistics For strategic impression variables and communication skills

| | Valid | Missing | Mean | St. Deviation | Minimum | Maximum |
|---|---|---|---|---|---|---|
| S1 | 101 | 1 | 3,7426 | 1,01640 | 1,00 | 5,00 |
| S2 | 102 | 0 | 3,9412 | 0,00910 | 1,00 | 5,00 |
| S3 | 101 | 1 | 3,5347 | 1,08226 | 1,00 | 5,00 |
| S4 | 101 | 1 | 3,5941 | 1,20148 | 1,00 | 5,00 |
| S5 | 101 | 1 | 3,5446 | 1,13600 | 1,00 | 5,00 |
| S6 | 102 | 0 | 3,8627 | 1,01513 | 1,00 | 5,00 |
| S7 | 101 | 1 | 3,7921 | 1,07997 | 1,00 | 5,00 |
| B1 | 100 | 2 | 4,1900 | 1,06073 | 1,00 | 5,00 |
| B2 | 101 | 1 | 4,0891 | 1,04975 | 1,00 | 5,00 |
| B3 | 102 | 0 | 3,4902 | 1,31062 | 1,00 | 5,00 |
| B4 | 100 | 2 | 3,7200 | 1,26395 | 1,00 | 5,00 |
| B5 | 102 | 0 | 3,5098 | 1,22471 | 1,00 | 5,00 |
| B6 | 102 | 0 | 4,373 | 1,02483 | 1,00 | 5,00 |
| B7 | 102 | 0 | 3,9510 | 1,09343 | 1,00 | 5,00 |
| B8 | 101 | 1 | 4,1485 | 1,00385 | 1,00 | 5,00 |
| B9 | 101 | 1 | 3,9109 | 114,104 | 1,00 | 5,00 |

It is seen that the average of variables in questionnaire that are related with strategic influencing skill is approximately 3.71. According to this result, it can be commented that the level of strategic influencing skill of managers is in average according to 5 points Likert Scale. The skill of “managing the working groups without damaging his/her reliability” has the highest percentage within the factors related to the strategic influencing skill. On the other hand, the skill of “developing a vision for the employees” has the lowest percentage.

It is seen that the average of variables in questionnaire that are related with intra-organizational communication level is approximately 3.90. According to this result, it can be commented that the intra-organizational communication level of managers is above the average according to 5 points Likert Scale. The skill of “caring about the correct timing of announcements” has the highest percentage within factors related to the intra-organizational communication level according to 5 points Likert Scale. On the other hand, the skill of “caring about the periodic meetings” has the lowest percentage.

It can be recommended to the leaders, who are in the scope of this study, to enhance their strategic influencing and intra-organizational communication level. In addition to this, these leaders should give more importance to “developing a vision for the employees” and “having periodical meetings”.

## Canonical Correlation Analysis

Here are the correlations among the variables in the analysis with the p-values and sample size edited out for better readability. SPSS performs canonical correlation using the manova command. The output below begins with an overall multivariate test of the entire model using four different multivariate criteria. This is followed by the seven canonical correlations and the multivariate tests of each of the dimensions. These results show that the first two of the seven canonical correlations are statistically significant at the .05 level. The results of Canonical Correlation Analysis are given in Table 4, 5 and 6.

**Table 4:** Multivariate Tests of Significance

| Test Name | Value | Approx. F | Hypoth. DF | Error DF | Sig. of F |
|---|---|---|---|---|---|
| | | | | | |
| Pillais | 1,57389 | 2,61053 | 63,00 | 567,00 | ,000 |
| Hotellings | 6,40242 | 7,44771 | 63,00 | 513,00 | ,000 |
| Wilks | ,06862 | 4,14330 | 63,00 | 428,51 | ,000 |
| Roys | ,84618 | | | | |

(S = 7, M = 1/2, N = 36 1/2)

**Table 5:** Eigenvalues and Canonical Correlations

| Root No. | Eigenvalue | Pct. | Cum. Pct. | Canon Cor. | Sq. Cor. |
|---|---|---|---|---|---|
| | | | | | |
| 1 | 5,50095 | 85,91979 | 85,91979 | ,91988 | ,84618 |
| 2 | ,363235 | ,67330 | 91,59309 | ,51619 | ,26645 |
| 3 | ,24828 | 3,87798 | 95,47107 | ,44598 | ,19890 |
| 4 | ,14756 | 2,30469 | 97,77576 | ,35858 | ,12858 |
| 5 | ,08760 | 1,36826 | 99,14402 | ,28381 | ,08055 |
| 6 | ,03484 | ,54416 | 99,68818 | ,18348 | ,03367 |
| 7 | ,01996 | ,31182 | 100,00000 | ,13991 | ,01957 |

**Table 6:** Dimension Reduction Analysis

| Roots | Wilks L. | F | Hypoth. DF | Error DF | Sig. of F |
|---|---|---|---|---|---|
| | | | | | |
| 1 TO 7 | ,06862 | 4,14330 | 63,00 | 428,51 | ,000 |
| 2 TO 7 | ,44608 | 1,40406 | 48,00 | 378,01 | ,046 |
| 3 TO 7 | ,60811 | 1,17030 | 35,00 | 326,34 | ,241 |
| 4 TO 7 | ,75910 | ,93626 | 24,00 | 273,32 | ,552 |
| 5 TO 7 | ,87111 | ,74658 | 15,00 | 218,49 | ,735 |
| 6 TO 7 | ,94742 | ,54750 | 8,00 | 160,00 | ,819 |
| 7 TO 7 | ,98043 | ,53904 | 3,00 | 81,00 | ,657 |

In general, the number of canonical dimensions is equal to the number of variables in the smaller set; however, the number of significant dimensions may be even smaller. Canonical dimensions, also known as canonical variates, are latent variables that are analogous to factors obtained in factor analysis. For this particular model there are seven canonical dimensions of which only the first two are statistically significant. The first test of dimensions tests whether all seven dimensions are significant (F = 4.14), the next test tests whether dimensions 2 up to 7 combined are significant (F = 1.40). Finally, the last test tests whether dimension 7, by itself, is significant (F = 0.53). Therefore dimensions 1 and 2 are each significant while the others are not.

SPSS presents the output separately for each of the two sets of variables. Within each set SPSS gives the raw canonical coefficients, standardized coefficients, correlations between observed variables and the canonical functions, and the percent of variance accounted for by canonical function. However these are further results that are not needed to be reported here.

According to these findings, it is concluded that two of the variables related to the strategic influencing skill: "managing the working groups without damaging his/her reliability" and "assessing whether the employees work in cooperation or not" have statistically significant relationship with intra-organizational communication level. Thus, it can be concluded that, there is a statistically relationship between strategic influencing skill and intra-organizational communication level of managers working for the organization which is in the scope of this research.

# REFERENCES

Adair J. (2005), *Etkili Stratejik Liderlik*, 2. Baskı, Yönetim Serisi, No:10, Babıâli Kültür Yayıncılık, İstanbul.

Akat İ., Budak G. and Budak G. (2002), *İşletme Yönetimi*, 4. Baskı, Beta Basım Yayım, İstanbul.

Alpar, R. (2003), *Uygulamalı Çok Değişkenli İstatistiksel Yöntemlere Giriş 1*, 2. Baskı, Nobel Yayınevi, Ankara.

Armstrong M. (2004), "How to be an Even Better Manager", *A Complete A-Z of Proven Techniques & Essential Skills*, First Edition, Kogan Page, London and Sterling, V.A.

Baker K. A., *Organizational Communication*, http://www.wrennetwork.net/resources/bencmark/13 OrganizationalCommunication.pdf, Erişim Tarihi: 04.11.2008.

Beatty K. C. & Hughes R. (2005a), Strategic Aims: Making The Right Moves in Leadership, *Leadership In Action*, Volume: 25, Issue: 4, pp. 3-6.

Beatty K. C. & Hughes R. L. (2005b), *Becoming Strategic Leader, Your Role in Your Organization's Enduring Success*, First Edition, Jossey-Bass a Writing Imprint, USA.

Boal K. B., Schultz P. (2007), Storytelling, Time, And Evolution: The Role Of Strategic Leadership In Complex Adaptive Systems, *The Leadership Quarterly*, 18, pp. 411-428.

Bratton J. (1999), “Communications and Employee Involvement”, *Human Resource Management*, (Editor: Bratton J., Gold J.), Second Edition, Macmillan Business, London, pp. 299-331.

Butts M.M., Vandenberg R.J., Dejoy D.M., Wilson M.G., (2006), Effects of Management Communication, Opportunity for Learning, and Work Schedule Flexibility on Organizational Commitment, *Journal of Vocational Behavior*, Volume: 68, Issue: 3, pp. 474-489.

Cocivera T. & Earn B., *Successful Leadership: Using Influence in Organizations*, www.open.uoguelph.ca/ external/leadershipchallenge, Erişim Tarihi: 04.12.2008.

Dalay İ., Coşkun R. & Altunışık R. (2002), *Stratejik Boyutuyla Modern Yönetim Yaklaşımları*, 1. Baskı, Beta Basım Yayım, İstanbul.

Dinçer Ö. (2003), *Stratejik Yönetim ve İşletme Politikası*, 6.Baskı, Beta Basım Yayım, İstanbul.

Dubrin A.J. (1997), *Essentials of Management*, Fourth Edition, South Western College Publishing, Ohio.

Dulupçu M.A. (2001), *Küresel Rekabet Gücü*, 1. Baskı, Nobel Basın Yayın ve Dağıtım, Ankara.

Erciş, S. (2002), Örgüt içi İletişimde Vizyoner Liderin Önemi, *İstanbul Üniversitesi İletişim Fakültesi Dergisi*, Yıl: 2002, Sayı: 14, İstanbul, ss. 449 – 462.

Erdem, O. (2009), *Çözüme Giden Yol*, Yakamoz Yayınevi, 1. Baskı, İstanbul.

Eren E. (2000), *Stratejik Yönetim ve İşletme Politikası*, 5.Baskı, Beta Basım Yayım, İstanbul.

Grunig J.E. (2005), *Halkla İlişkiler ve İletişim Yönetiminde Mükemmellik*, (Çeviren: Özsayar E. - Editör: Görpe S.), 1. Baskı, Tribeca İletişim-Danışmanlık, Rota Yayınları, İstanbul.

Harari O. (1996), Quotations Firm Chairman Powell, Leadership Primer, *Management Review*, Volume: 85, Issue: 12, pp. 34-104.

Hatipoğlu Z. (1993), *Temel Yönetim ve Organizasyon*, 1. Baskı, Beta Yayınları, Yeni İktisat ve İşletme Yönetimi Dizisi, No:12, İstanbul.

Hegeman G. (1995), *The Motivation Manuel,* 1. Baskı, Rota Yayıncılık, İstanbul.

Hitt M. A., Ireland R. D., Haskinson R. E. (1999), *Strategic Management, Competitiveness and Globalization*, Third Edition, South Western Publishing, Ohio.

Hodgetts R. M. (1997), *Yönetim, Teori, Süreç ve Uygulama*, (Çeviren: Çetin C., Mutlu E. C.), Der Yayınları, İstanbul.

Holley R. (1996), Looking Leaders Tackle Different Situations with Playback, Full of Actions, *Info World*, Volume:18, Issue:47.

Hout T. M., Carter J. C. (1998), *Yöneticilikte Yeni Roller*, *Harvard Business Review*, Power Özel Eki, İstanbul.

Işık M. (2002), *Kitle İletişim Teorilerine Giriş,* Eğitim Kitabevi Yayınları, 1. Baskı, Ankara.

Karatepe S. (2005), *Örgütlerde İletişim-Güdüleme İlişkisi*, 1. Baskı, Siyasal Kitabevi Yayını, Ankara.

Katz D. and Kahn R.L. (1997), *Örgütlerin Toplumsal Psikolojisi*, 1. Baskı, (Çeviren: Can H., – Bayar Y.), TODAİE Yayın, No: 167, Doğan Basımevi, Ankara.

Kennedy, J.R.M. and Anderson R.D. (2005), Subordinate-Manager Gender Combination and Perceived Leadership Style Influence On Emotions, Self-Esteem and Organizational Commitment”, *Journal of Business Research*, Volume 58, Issue 2, pp. 115-125.

Keçecioğlu T. (2003), *Lider ve Liderlik*, 1. Baskı, Okumuş Adam Yayınları, Yayın No:19, İstanbul.

Koçel T. (2005), *İşletme Yöneticiliği*, 10.Baskı, Beta Basım Yayım, İstanbul.

Kreps G.L. (1990), *Organizational Communication: Theory and Practice*, Second Edition, Longman, New-York.

Mccoll J. R., Anderson Kennedy and Ronald D. (2005), Subordinate-Manager Gender Combination And Perceived Leadership Style Influence On Emotions, Self-Esteem And Organizational Commitment, *Journal of Business Research*, Volume: 58, Issue: 2, pp. 115-125.

Mcnamara C., *Basics In Internal Organizational Communications*, MBA, PhD, Authenticity Conculting, LLC, http:/www.managementhelp.org/mrktng/org-cmm.htm, Erişim Tarihi: 04.11.2008.

Mowday R.T., Porter E.W., Steers R.M. (1982), *Employee-Organization, Linkages,* First Edition, Academic Press, New York.

Özdamar, K. (2002), *Paket Programlar ile İstatistiksel Veri Analizi–1, SPSS-MINITAB*, 4. Baskı, Kaan Kitabevi, Eskişehir.

Paulraj, A.L., Chen A.A. (2008), Inter-Organizationel Communication As a Relation Competency: Antecedents And Performance Outcomes In Collaborative Buyer-Supplier Relationships, *Journal of Operations Management*, Volume: 26, Issue: 1, pp: 45- 64.

Rhinesmith S. H. (2000), *Yöneticinin Küreselleşme Rehberi*, 1. Baskı, Çeviri, (Çeviren: Şen G.), Sabah Kitapları, İstanbul.

Shocley- Zalabak P. (1991), *Fundementals of Organizational Communication,* Second Edition, Longman Publishing, New-York.

Snider, D. (2008), Dissent and Strategic Leadership of the Military Professions, *Orbis*, Volume: 52, Issue: 2, pp. 256-277.

Tortop N., İsbir E.G., Aykaç B., Yayman H., Özer M.A. (2007), *Yönetim Bilimi*, Genişletilmiş ve Gözden Geçirilmiş 7. Baskı, Nobel Yayın ve Dağıtım, Ankara.

Visser, B. (2000), Organizational Communication Structure And Performance, "Journal of Economic Behavior & Organization, Volume: 42, pp. 231-252.

Vugt, S., Jepson, F., Hart, and Cremer M.D. (2004), Autocratic Leadership In Social Dilemmas: A Threat To Group Stability, *Journal of Experimental Social Psychology*, Volume: 40, Issue: 1. pp.1-13.

Wasti S.A. (2005), Commitment Profiles: Combinations of Organizational Commitment Forms and Job Outcomes, *Journal of Vocational Behavior*, Volume: 67, Issue: 2, pp. 290-308.

www.cd.org, *Stratejik Liderlik, Kaynak Dergisi*, Ocak-Mart 2004, Erişim Tarihi: 25.12.2008.

www.insankaynakları.com, Erişim Tarihi: 25.12.2008.

www.stratejiyönetim.com, Paradoksal Liderlik, Erişim Tarihi: 07.04.2008.

Yousef D.A. (2000), Organizational Commitment: A Mediator of The of Leadership Behavior With Job Satisfaction and Performance In Non-Western Country, *Journal of Managerial Psychology*, Volume: 15, Issue: 1, pp. 6-24.

# CREATIVITY FOR GAINING AND SUSTAINING COMPETITIVE ADVANTAGE: THE ROLE OF LEADERSHIP STYLES (A QUANTITATIVE RESEARCH IN TURKEY'S TOP 500 INDUSTRIAL ENTERPRISES IN IRON AND STEEL, AUTOMOTIVE AND TEXTILE INDUSTRIES)

**F. Oben Ürü**
**Haliç University, Turkey**

**Uğur Yozgat**
**Marmara University, Turkey**

## ABSTRACT

*The main object of this paper is to examine the effect of leadership styles on employee creativity. Thus the research was performed in Iron and Steel, Automotive and Textile industries listed in Istanbul Chamber of Industry's Turkey's Top 500 Industrial Enterprises 2008. As the results of analyses, transformational, transactional and laissez-faire leadership styles have effect on employee creativity (64%), controlling creative personality. Also results show that creative personality had a strong explanatory effect on employee creativity (54,5%). It is determined that, "Challenge & Enjoyment" partially mediated the relationship between leadership styles and employee creativity and it increased employee creativity 16,9%. In addition Climate for Creativity partially mediated the relationship between leadership styles and employee creativity, and it increased employee creativity 14, 9%. On the other hand, Compensation partially moderated between transactional leadership and employee creativity and between transformational leadership and employee creativity; Acceptance partially moderated between transactional leadership and employee creativity, and Goal Setting partially moderated between transformational leadership and employee creativity. Results also show that Compensation had a negative association with creativity. Finally, it was seen that Conservation partially moderated between transformational leadership and employee creativity. This study's theoretical contribution is examination of effects of leadership styles on employee creativity in a comprehensive model; proposing new mediating and moderating variables in this correlation and filling this gap in the research. Furthermore, this study's practical contribution is there is lack of research that consists of stated variables in our model conducted such a wide scope. And finally, the methodological contribution of this study is investigation of leadership styles and employee creativity in Turkey, a developing country; it shows the external validity of these theories which were developed and tested in Western developed countries.*

***Key Words: Leadership Styles, Employee Creativity, Intrinsic and Extrinsic Motivation, Creative Personality***

## INTRODUCTION

The depth, breadth, and speed of change that engulfs businesses today, and trends such as globalization, technology advancement, and the knowledge-based economy have put increasing pressure on business creativity and innovation (Ford & Gioia, 1995; Kim & Mauborgne, 2005). A number of factors have resulted in creativity becoming more critical across jobs and organizations. For example, creativity has become and will remain indispensable as organizations and their environments change fundamentally (Ford & Gioia, 1995), and as jobs become more complex and work designs include more autonomy (Oldham & Cummings, 1996). In order to survive, adapt, and gain competitive advantage, organizations need to unleash their employees' innate creative potential, because employees' creative ideas can be used as building blocks for organizational innovation, change, and competitiveness (Amabile, 1988; Woodman, Sawyer & Griffin, 1993, Zhou & George, 2003). Gupta and Singhal (1993) found that successful organizations create competitive advantage in the marketplace through innovation by revealing their employees' creativity. If we view employees as resources in the competitive marketplace, the question then becomes how their creativity can be fostered for the organization's purpose. Until recently, research on employee creativity focused on identifying personal characteristics and work environment that related to creative performance. Although many variables influence employees' creativity in organizational settings, there is reason to suspect that leaders and their behavior represent a particularly powerful influence. The role of the leadership in employee creativity has been researched by organizational scholars in this decade. Research shows that leaders have at their disposal various means to influence creativity in their organizations (Mumford, Scott, Gaddis, & Strange, 2002) and leaders could influence their followers' creativity by altering their leadership style into transformational leadership to expose their creativity (Jung & Avolio, 1999; Kahai, Sosik, & Avolio, 1997; Sosik, Avolio, & Kahai, 1997, 1998; Sosik, Kahai, & Avolio, 1998). Thus, employees' creativity can be fostered for the organization's purpose. Furthermore, most of the research has been conducted in Western countries, primarily in the United States. From the literature review, it is seen that there is lack of research about the role of leadership styles on employee creativity in Turkey. Given the lack of academic research about this topic in Turkey, the aim of this study is to examine the effect of leadership styles on employee's creativity, focusing on the Turkey's Top 500 Industrial Enterprises. In addition, this study analyzes personal characteristics (eg. creative personality, intrinsic motivation, conservation) and work environment (climate for creativity, extrinsic motivation) in this relation. Figure 1 shows our model developed for this purpose.

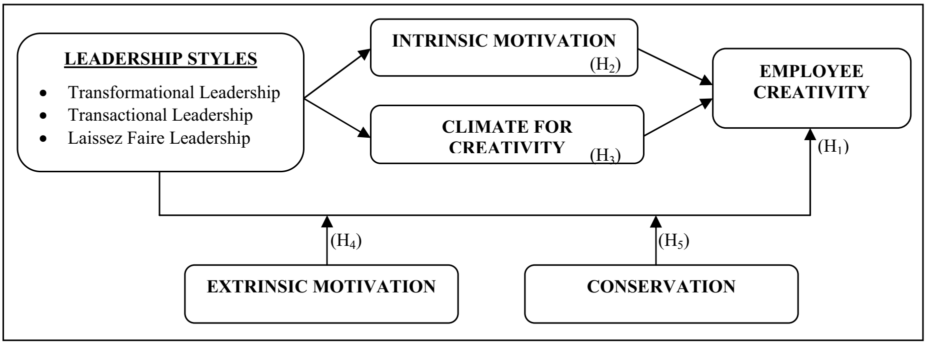



**Figure 1: The Proposed Model**

According to the proposed model, leadership styles effect on employee creativity ($H_1$). Employees' intrinsic motivation and climate for creativity mediate this effect ($H_2$, $H_3$). Furthermore, extrinsic motivation and conservation moderate in this effect ($H_4$, $H_5$). On top of all this, our model proposes control variables like creative personality, educational level, and job tenure since they are related to creativity.

# THEORETICAL BACKGROUND AND HYPOTHESES

## Employee Creativity and Leadership Styles

Creativity has been an important topic in our global world as well as in the social sciences for last decades. There has been a growing consensus among creativity researchers regarding the appropriateness of defining creativity in terms of an outcome (Amabile, 1983) such as an idea or product (Amabile, 1988; Woodman, Sawyer & Griffin, 1993). Nonetheless, Amabile's definition of creativity as the "production of novel and useful ideas" (1988:126) has been cited and used in many studies, and has become the most common one (e.g. Oldham & Cummings, 1996; Tierney, Farmer & Graen, 1999; Prabhu, Sutton & Sauser, 2008). Consistent with these studies, we defined creativity as the generation of novel, unique, and original ideas that are related to processes and procedures used in workplace. The bulk of research on creativity over the years has emphasized the examination of employee creativity in workplace (e.g. Amabile, 1988; Oldham & Cummings, 1996; Woodman, Sawyer & Griffin, 1993) as it relates to companies' competitive advantage. Since employees' creativity has seen as a requirement for innovation as well as surviving and adapting in challenging world, and gaining competitive advantage, many researchers seek to find what effects employees' creativity and in which conditions employees' creative performance can be increased. Research refers to leaders' behaviors have a powerful effect and noticeable impact on followers creativity. Therefore, this study examines the leadership styles' effect on employees' creativity. Before digging into the research determining the relationship between employees' creativity and leadership styles, it would be appropriate to give the definition of leadership and expansion of leadership styles.

In the literature, many authors which have interest in studying topic of leadership, offered definitions of leadership and defined this concept as a complex process by which a person influences others, applying his/her leadership attributes like belief, values, ethics, character, knowledge and skills, to accomplish a mission, task or objective and directs the organization in a way that makes it more cohesive and coherent (Yukl, 1989:252; Boune & Kurtz, 1990:183; Nelson & Quick, 1994:358; Cook, Hunsaker & Coffey, 1997:463; Greenberg & Baron, 2000:445). In addition to, it is seen that there are differences in connection with the types of leadership. Burns (1978) was one of the firsts to identify two types of leadership styles, transformational and transactional. Further these leadership styles refined by Bass (1985). Furthermore, accepted common theory about leadership styles came from Bass & Avolio (1995). According to them, leadership styles consist of transformational, transactional and laissez-faire leadership. As to them, transformational leaders motivate others to do more than they originally intended and often even more than they thought possible. They set more challenging expectations and typically achieve higher performances (Bass & Avolio, 1994:3). Factor analytic study by Bass & Avolio (1995) has suggested that transformational leadership can be conceptually organized along four correlated dimensions: *charisma- idealized influence*, *inspirational motivation*, *intellectual stimulation* and *individualized consideration*. Using charisma, the leader inspires admiration, respect, and loyalty, and emphasizes the importance of having a collective sense of mission. By inspirational motivation, the leader creates a clear picture of the future state that is both optimistic and attainable, and encourages others to raise their expectations, reduces complexity to key issues and uses simple language to convey the mission. By intellectual stimulation, leaders stimulate their followers' efforts to be innovative and creative by questioning assumptions, reframing problems, and approaching old situations in new ways. By individualized consideration, leaders pay special attention to each individual's needs for achievement and growth by acting as coach or mentor (Bass & Avolio, 1994:3). According to Bass & Avolio (1994:4) transformational leadership is an expansion of transactional leadership. Transactional leadership emphasizes the transaction or exchange that takes place among leaders, colleagues, and followers. This exchange is based on the leader discussing with others what is required and specifying the conditions and rewards these others will receive if they fulfill those requirements. That is to say, transactional leadership occurs when the leader rewards or disciplines the follower depending on the adequacy of the follower's performance. Transactional leadership diverges from transformational leadership in that the transactional leader does not individualize the needs of subordinates nor focus on their personal development (Northouse, 2001:140). In other words, transactional leader motivates subordinates to perform as expected while the transformational leader typically inspires followers to do more than originally expected (Hartog & Van Muijen, 1997:21). Transactional leadership depends on contingent reinforcement, either positive *contingent reward (CR)* or the more negative *active or passive forms of management by exception (MBE-A or MBE-P)*. By contingent reward, the leader assigns or gets agreement on what needs to be done and promises rewards or actually rewards others in exchange for satisfactorily carrying the assignment (Bass & Avolio,1994:4). Leaders who practice management by exception have implicit trust in their workers to finish the job to a satisfactory standard. These leaders do not inspire the workers to achieve beyond expected outcomes (Santora & Sarros, 2001:389). By MBE-A, the leader actively seeks to deviations from rules and standard procedures and takes corrective action when irregularities occur. On the other hand, by MBE-P, the leader take action after deviations and irregularities have occurred and standards are not met (Bass & Avolio, 1994:4). The difference between the two is that in MBE-A, the leader search for deviations, whereas in MBE-P the leader waits for problems to materialize (Bass, 1990; Lowe & Galen Kroeck, 1996; Hartog & Van Muijen, 1997). In essence, both MBE-A and MBE-P types use more negative reinforcement patterns than positive reinforcement pattern described under contingent reward (Northouse, 2001:141). The laissez-faire style is the avoidance or absence of leadership and is, by definition, the most inactive – as well as the most ineffective according to almost all research on the style (Bass & Avolio, 1994:4). There is a negative association between laissez-faire leadership and a variety of subordinate performance, and effort indicators, which implies that laissez-fare leadership is an inappropriate way to lead. By laissez-faire it is meant that the leader is not sufficiently motivated or adequately skilled to perform supervisory duties. While this statement seems to be correct, there are also situations in which highly active leadership is not necessary. Hartog & Van Muijen (1997) state that a less active role of leaders could also lead to empowerment of followers which could even make for a useful component of transformational leadership.

After revealing the leadership literature, it will be convenient to represent some of the studies examining the leadership effect on followers' creativity. In the literature, it is seen that leadership behaviors closely match the determinants of creativity at the workplace, some of which are vision, support for creativity, encouragement and challenge. For example, Bass & Avolio (1995) and Sosik, Kahai, & Avolio (1998)

determined in their studies that leader's behaviors especially transformational one, are likely to act as "creativity-enhancing forces": individualized consideration "serves as a reward" for the followers by providing recognition and encouragement; intellectual stimulation "enhances exploratory thinking" by providing support for creativity and challenge, and inspirational motivation "provides encouragement into the idea generation process" by energizing followers to work towards the organization's vision. On the other hand, by highlighting desirable outcomes that would result from a successful discussion (e.g. a long list of ideas, a feeling of satisfaction), a transactional leader can build effort-accomplishment expectancies to extrinsically motivate creativity-relevant contributions to the employees (Kahai, Sosik, & Avolio, 2003:503). However Jung (2000:188) stated that there are no active and intentional efforts made by the transactional leader to enhance followers' creativity. Followers are extrinsically motivated to perform their job under the transactional leader, which may hold creativity at the minimal level (Amabile, 1998).
On the basis of the previous discussion and examination of the research concerned with employee creativity and leadership styles, the following hypothesis is advanced: **$H_1$: Leadership styles effect on employee creativity. Namely, transformational leadership has more positive effect on employee creativity than transactional and laissez-faire leadership.**

## Intrinsic & Extrinsic Motivation, Employee Creativity and Leadership Styles

In the literature it seen that there are two types of motivation; extrinsic and intrinsic. Intrinsic motivation represents a motivational situation in which employees performs a task due to the sheer fascination of the task itself, rather than for the external outcomes or rewards related to the task whereas external motivation occurs when a task is related to these external outcomes or rewards (Deci & Ryan, 1985). Research show intrinsic motivation is the key ingredient in the creativity (Amabile, 1988, 1998, Amabile et al., 1996). To the effect that, while an employee is intrinsically attracted to a task, he/she is more likely to focus on it explore and experiment with it, hence exhibit more creative performance and behavior (Tierney, Farmer & Graen, 1999). Oldham & Cummings (1996) specified leader behaviors are important determinants of intrinsic motivation and creativity at work. For example, transformational leaders who care for their employees' feelings and needs, facilitate their skill development, show them ways to achieve the goals and express confidence in them are likely to enhance their employees' interest in their tasks.
Based on the discussion above, this study proposes that leadership styles affect employee creativity through intrinsic motivation. Therefore, **$H_2$: Intrinsic motivation mediates the relationship between leadership styles and employee creativity.**

On top of all this, research shows extrinsic motivation also has an incremental effect on creativity (Eisenberger, Rhoades & Cameron, 1999; Eisenberger & Rhoades, 2001; Prabhu, Sutton & Sauser, 2008). Some researchers stated intrinsic motivation has more effect on employee creativity than extrinsic motivation (Amabile, 1983; Hennessey & Amabile, 1988). Deci (1971) specified under certain conditions extrinsic motivation has a negative impact on intrinsic motivation. In addition to, Prabhu, Sutton & Sauser (2008) found extrinsic motivation had a negative impact on creativity when extrinsic motivation at high levels. However, more recent studies have not only negated some of the prior research about the negative impact of extrinsic motivation on creativity, on the contrary, have found that, under certain circumstances, extrinsic motivation was positively related to creativity (Prabhu, Sutton & Sauser, 2008:57, Mumford, Scott, Gaddis, & Strange, 2002). Consequently, there are tasks and duties challenging and interesting (intrinsically motivating) at workplace but there are also tasks which are extrinsically motivated (Prabhu, Sutton & Sauser, 2008:57). Furthermore, as seen in the research, intrinsic and extrinsic motivation could aid employees' creativity. Intrinsic motivation could be essential for the novelty in the work, although extrinsic motivation can help to ensure a timely and complete output (Prabhu, Sutton & Sauser, 2008:57). Hence, the following hypothesis is advanced: **$H_4$: Extrinsic motivation moderates the relationship between leadership styles and employee creativity.**

## Climate for Creativity, Employee Creativity and Leadership Styles

In the literature, many authors defined climate as a cognitive interpretation of an organizational situation that has been labeled "psychological climate". Climate represents signals individuals receive concerning organizational expectations for behavior and potential outcomes of behavior (Scott & Bruce, 1994:582). And research show organizational climate affect employees' creativity (Siegel & Kaemmerer, 1978; Scott & Bruce, 1994; Amabile et al., 1996). Scott & Bruce (1994) specified organizational climate is an important factor for creativity since employees' perceptions of the extent to which creativity is encouraged at the workplace, and the extent to which organizational resources are allocated to supporting creativity influence creative performance. In addition to, employees' perceptions of a creative climate encourages risk-taking and the challenge to use creative approaches at work. Hence, Scott & Bruce (1994) found that existing climate for creativity enhances employee creativity through adequate supplies of resources such as time, equipment, and facilities are critical to employee creativity. On top of all this, research refers leadership styles also have an important effect on employee creativity through its influence on the employees' perceptions of a climate supportive of creativity. Amabile, et al. (1996) and Scott & Bruce (1994) stated the leader can establish a work environment encouraging creativity and create an organizational climate that serves as a guiding principle for more creative work processes. Especially transformational leaders could establish a climate where employees feel challenged and energized to seek creative behaviors for their tasks and duties by intellectually stimulating employees' efforts to be innovative and creative through questioning assumptions, reframing problems, and approaching old situations in new ways and articulating a compelling vision throughout the organization. According to these findings, this study proposes that leadership styles affect employee creativity through creative climate. Therefore, **$H_3$: Climate for creativity mediates the relationship between leadership styles and employee creativity.**

## Conservation, Employee Creativity and Leadership Styles

Individual beliefs, values and norms effect the relation between leader and follower (Yukl, 1992; Bass, 1997:137). Namely, different employees could evaluate same leader in different ways and react his/her differently. In this context, research refers employees who value conformity, security, and tradition affiliate themselves with their leader (Schwartz, 1994, 1999; Ros, Schwartz & Surkiss, 1999). Employees having "basic individual values" such as conformity, security, and tradition-named *conservation* by Schwartz (1992)-could react positively to the leadership especially to transformational leadership (Jung & Avolio, 1999; Shin & Zhou, 2003). In addition to, values and self concepts act as intervening mechanisms by which leaders influence followers (Lord, & Brown, 2001). In contrast to these findings, recent studies (e.g. Kasof et al., 2007) show that creative behavior is discouraged primarily by the tradition value type and secondarily by the conservation -conformity and security value types-.In the present study, we addressed these different findings in the literature, and wanted to ascertain whether creative behavior is prevented or promoted by conservation. Hence the moderating role of conservation is hypothesized: **$H_5$: Conservation moderates the relationship between leadership styles and employee creativity.**

# METHODOLOGY

## The Main Objective and Scope of the Research

The main objective of this research is to examine the effect of leadership styles on employee creativity. This research comprises industrial enterprises in Iron and Steel, Automotive and Textile industries listed in Istanbul Chamber of Industry's Turkey's Top 500 Industrial Enterprises 2008. In this context, white collar employees' opinions and attitudes are taken as base.

## Data Collection Method, Procedures and Type of Research

This study was performed by explanatory research model. According to this, the effects of leadership styles on employee creativity were explained and identified. ***The population of this study*** was composed of Turkey's Top 500 Industrial Enterprises listed in Istanbul Chamber of Industry's Turkey's Top 500 Industrial Enterprises 2008. ***Research sample*** consisted of 187 enterprises of Iron and Steel, Automotive and Textile industries listed in Istanbul Chamber of Industry's Turkey's Top 500 Industrial Enterprises 2008. Data were collected through **structured questionnaires**. In this research **all of the 187 enterprises** in the Turkey's Top 500 Industrial Enterprises list of stated industries **are reached** via e-mail and telephone. The questionnaires are given all of the specified enterprises through face-to-face interviews or via postal 100 each. But some of the participants excused for not answering the questionnaires by reason of their workload or length of the questions in the questionnaire. Hence 187 of 85 specified enterprises returned; thereby **85 specified enterprises of 3548 employees'** answers included in this research. Details of dispersion of the questionnaires to the industries are exhibited in Table 1.

**Table 1. Dispersion of the Questionnaires to the Industries**

| INDUSTRIES | Population (Total Number of Enterprises) | Sample Size (Number of the Enterprises Answered the Questionnaire*) | Sampling Ratio (%) | Number of the Employees Answered the Questionnaire** |
|---|---|---|---|---|
| Iron and Steel Industry | 77 | 37 | 48,05 | 1491 |
| Automotive Industry | 49 | 23 | 46,94 | 1025 |
| Textile Industry | 61 | 25 | 40,98 | 1032 |
| **TOTAL** | **187** | **85** | **45,45** | **3548** |

*Minimum 30, maximum 85 questionnaires returned from each enterprises answering questionnaire.

**Number of the employees answered the questionnaire consists of employees answering questions in the questionnaire completely and consistently (questionnaires with missing and inconsistent statements were excluded)

## Measures

The questionnaire prepared for white collar employees, consisted of 150 questions in 7 parts for measuring sample's demographic characteristics and variables proposed in the research model; thereby in this research 6 different scales were used. In the first part of the questionnaire, for measuring leadership style *(Independent Variable)* Bass and Avolio's MLQ: Multifactor Leadership Questionnaire was used. MLQ is first developed in 1985 since then it had been improved several times. In this study, MLQ 5X[3] translated into Turkish by Yurtkoru (2001) was used. This questionnaire had three dimensions, 36 items all together and measured on a 5 point scale. These dimensions can be seen in Figure 1. In the second part, intrinsic and extrinsic motivation were measured on a 4 point scale by 30 items of WPI: The Work Preference Inventory adapted from Amabile et al. (1994). In the third part, for measuring climate that support creativity, Scott and Bruce's (1994) Climate for the Innovation Measure which has 22 items was used and measured on a 5 point scale. In the fourth part, conservation was measured on an 8 point scale by 16 items of human values test adapted from Schwartz (1992). In the fifth part, creative personality *(control variable)* was measured by 30 adjectives of CPS: Creative Personality Scale adapted from Gough (1979). In the sixth part, employee creativity *(Dependent Variable)* was measured on a 7 point scale by 11 items of Creativity Measure (Self Report) adapted from Muñoz-Doyague et al.(2008). And finally in the last part, demographic questions for measuring descriptives and other control variables such as educational level, and job tenure are asked. Permissions from authors developed these scales for using in the research was granted.

## Statistical Analysis

In the direction of testing of the research model and purpose of the research, SPSS 16.0 Statistical Package and following statistical analysis were used. First, for measuring participants' demographic characteristics frequency analyses were done. Second, factor and reliability analyses were performed towards the determination of the factor structures and internal consistencies of the scales. In this context, exploratory factor analysis using principal components method and varimax rotation was conducted on the items of the scales. Third, to determine means, standard deviations and to understand correlations among all factors came out in the factor analysis, descriptive statistics, and Pearson correlation analysis were performed. And last, testing of the effects of the independent variables upon the dependent variables and mediating/moderating effects, multiple regression analyses and hierarchical regression analyses were conducted.

# FINDINGS

## Frequency Analysis

Demographic questions were analyzed according to frequency. In Table 2, frequency analysis shows the sample of the questionnaire.

**Table 2. Sample's Demographic Characteristics**

| DEMOGRAPHIC CHARACTERISTICS | CATEGORIES OF VARIABLES | IRON AND STEEL INDUSTRY | | AUTOMOTIVE INDUSTRY | | TEXTILE INDUSTRY | | GENERAL | |
|---|---|---|---|---|---|---|---|---|---|
| | | f | % | f | % | f | % | f | % |
| ***Gender*** | Female | 368 | 75,3 | 176 | 17,2 | 223 | 21,6 | 767 | 21,6 |
| | Male | 1123 | 24,7 | 849 | 82,8 | 809 | 78,4 | 2781 | 78,4 |
| ***Age*** | 21-29 | 179 | 12 | 315 | 30,7 | 339 | 32,8 | 833 | 23,5 |
| | 30-40 | 749 | 50,2 | 632 | 61,7 | 587 | 56,9 | 1968 | 55,5 |
| | 41-58 | 563 | 37,8 | 78 | 7,6 | 106 | 10,3 | 747 | 21 |
| ***Marital Status*** | Single (Unmarried) | 224 | 15 | 260 | 25,4 | 269 | 26,1 | 753 | 21,2 |
| | Married | 1158 | 77,7 | 738 | 72 | 743 | 72 | 2639 | 74,4 |
| | Widowed | 109 | 7,3 | 27 | 2,6 | 20 | 1,9 | 156 | 4,4 |
| ***Educational Level*** | Elementary School | - | - | - | - | 3 | 0,3 | 3 | 0,1 |
| | Secondary School | - | - | - | - | 4 | 0,4 | 4 | 0,1 |
| | High School | 107 | 7,2 | 28 | 2,7 | 70 | 6,8 | 205 | 5,8 |
| | Vocational School | 461 | 30,9 | 182 | 17,8 | 209 | 20,3 | 852 | 24 |
| | University | 803 | 53,8 | 671 | 65,5 | 661 | 64,1 | 2135 | 60,1 |
| | Master's | 119 | 8 | 142 | 13,9 | 85 | 8,2 | 346 | 9,8 |
| | Doctorate | 1 | 0,1 | 2 | 0,1 | 3 | 0,3 | 3 | 0,1 |
| ***Department*** | Research & Development | 25 | 1,7 | 39 | 3,8 | 6 | 0,6 | 70 | 2 |
| | Information Systems | 3 | 0,2 | 17 | 1,6 | 12 | 1,2 | 32 | 0,9 |
| | Foreign Trade | 117 | 7,8 | 100 | 9,8 | 50 | 4,8 | 267 | 7,5 |
| | Administrative Affairs | 84 | 5,6 | 25 | 2,4 | 72 | 7 | 181 | 5,1 |
| | Human Resources | 122 | 8,2 | 162 | 15,8 | 145 | 14 | 429 | 12,1 |
| | Quality Improvement | 128 | 8,6 | 93 | 9,1 | 57 | 5,5 | 278 | 7,8 |
| | Logistics | 22 | 1,4 | 29 | 2,9 | 1 | 0,1 | 52 | 1,4 |
| | Financial Affairs | 148 | 10 | 17 | 1,7 | 89 | 8,6 | 254 | 7,1 |
| | Marketing-Sales | 390 | 26,2 | 243 | 23,7 | 313 | 30,3 | 946 | 26,7 |
| | Planning | 64 | 4,3 | 22 | 2,1 | 51 | 4,9 | 137 | 3,9 |
| | Project Development | 5 | 0,3 | 29 | 2,8 | 9 | 0,9 | 43 | 1,2 |
| | Purchasing | 74 | 5 | 30 | 2,9 | 41 | 4 | 145 | 4,1 |
| | After Sales | - | - | 13 | 1,3 | 8 | 0,8 | 21 | 0,6 |
| | Research Design | - | - | - | - | 10 | 1 | 10 | 0,3 |
| | Technical | 15 | 1 | 8 | 0,8 | 7 | 0,7 | 30 | 0,8 |
| | Production | 294 | 19,7 | 198 | 19,3 | 161 | 15,6 | 653 | 18,5 |
| ***Work Experience*** | 6 month - 5 years | 225 | 15,1 | 319 | 31,1 | 312 | 30,2 | 856 | 24,1 |
| | 5,5 - 10 years | 442 | 29,6 | 462 | 45,1 | 410 | 39,8 | 1314 | 37 |
| | 11 -15 years | 405 | 27,2 | 185 | 18 | 221 | 21,4 | 811 | 22,9 |
| | 16 - 20 years | 291 | 19,5 | 57 | 5,6 | 84 | 8,1 | 432 | 12,2 |
| | 21 - 48 years | 128 | 8,6 | 2 | 0,2 | 5 | 0,5 | 135 | 3,8 |
| ***Job Tenure (In the Current Firm)*** | 4 month - 3 years | 285 | 19,1 | 224 | 21,9 | 247 | 23,9 | 756 | 21,3 |
| | 3,5 years - 8 years | 715 | 48 | 584 | 57 | 623 | 60,4 | 1922 | 54,2 |
| | 9 -12 years | 308 | 20,7 | 178 | 17,3 | 141 | 13,7 | 627 | 17,7 |
| | 13 - 29 years | 183 | 12,2 | 39 | 3,8 | 21 | 2 | 243 | 6,8 |

Note. $N$=3548

## Factor and Reliability Analyses

***Multifactor Leadership Scale (MLQ).*** As a result of Cronbach's reliability analysis performed for MLQ, 3 items decreased the reliabilities were eliminated and the scale had a strong reliability (Cronbach's α= .969). Therefore factor analysis repeated. After factor analysis (principle component analysis with varimax rotation) was conducted, 3 factors which Eigenvalues ≥1 obtained consisting of 33 items (KMO=0,943, $X^2_{\text{Bartlett test}}$ (561)=116900 $p$=0,000). Total variance explained was %74,864. Scale factors were found as in the original, so we named these factors like the original in turn; “Transformational Leadership *(Cronbach α=.958, % of Variance=42,786)*”, “Transactional Leadership *(Cronbach α=.894, % of Variance=21,731)*”, , “Laissez-Faire Leadership *(Cronbach α=.84, % of Variance =10,347)*”.

***Intrinsic Motivation Scale (WPI-IM).*** As a result of Cronbach’s reliability analysis performed for intrinsic motivation, 2 items decreased the reliabilities were eliminated and the scale had a strong reliability (Cronbach’s α= .941). Therefore factor analysis repeated. After factor analysis was performed, 2 factors which Eigenvalues ≥1 obtained consisting of 13 items (KMO=0,921, $X^2_{\text{Bartlett test}}$ (78)=37020 $p$=0,000). Total variance explained was %67,896. Scale factors were found unlike the original, so we named these factors in turn as; “Challenge and Enjoyment *(Cronbach α=.94, % of Variance=45,009)*”, “Self-Expression and Satisfaction *(Cronbach α=.779, % of Variance=22,887)*”.

***Extrinsic Motivation Scale (WPI-EM).*** As a result of Cronbach’s reliability analysis performed for extrinsic motivation, 4 items decreased the reliabilities were eliminated and the scale had a reliability as Cronbach’s α= .723. Therefore factor analysis repeated. After factor analysis was performed, 4 factors which Eigenvalues ≥1 obtained consisting of 11 items (KMO=0,689, $X^2_{\text{Bartlett test}}$ (55)=18360 $p$=0,000). Total variance explained was %76,347. Scale factors were found unlike the original, so we named these factors in turn as; “Compensation (*Cronbach α=.82, % of Variance=23,602)*”, “Reward *(Cronbach α=.769, % of Variance=19,074)*”, “Acceptance (*Cronbach α=.885, % of Variance=17,082)*”, “Goal Setting *(Cronbach α=.704, % of Variance=16,589)*”.

***Climate for Creativity Scale.*** As a result of Cronbach’s reliability analysis performed for climate that support creativity, 3 items decreased the reliabilities were excluded and the scale had a strong reliability (Cronbach’s α= .972). Therefore factor analysis repeated. After factor analysis was performed, 2 factors which Eigenvalues ≥1 obtained consisting of 19 items (KMO=0,941, $X^2_{\text{Bartlett test}}$ (171)=81250 $p$=0,000). Total variance explained was %73,744. Scale factors were found unlike the original, so we named these factors in turn as; “Tolerance of Differences *(Cronbach α=.947, % of Variance=36,901)*”, “Support for Creativity and Resource Supply *(Cronbach α=.959, % of Variance=36,843)*”.

***Conservation Scale.*** As a result of Cronbach’s reliability analysis performed for conservation, 7 items decreased the reliabilities were eliminated and the scale had a reliability as Cronbach’s α= .803. Therefore factor analysis repeated. After factor analysis was performed, 1 factor which Eigenvalue ≥1 like the original scale obtained consisting of 9 items (KMO=0,877, $X^2_{\text{Bartlett test}}$ (36)=10600 $p$=0,000). Total variance explained was %65,560.

***Creativity Scale.*** As a result of Cronbach’s reliability analysis performed for creativity, 2 items decreased the reliabilities were eliminated and the scale had a strong reliability (Cronbach’s α= .969).Therefore factor analysis repeated. After factor analysis was performed, 1 factor which Eigenvalue ≥1 like the original scale obtained consisting of 9 items (KMO=0,915, $X^2_{\text{Bartlett test}}$ (36)=44700 $p$=0,000). Total variance explained was %80,604.

***Creative Personality Scale (CPS).*** Reliability of the CPS was calculated via a weighted composite technique generated by Oldham ve Cummings (1996). As a result of reliability analysis performed for creative personality, 8 adjectives decreased the reliabilities were excluded and the scale had a strong reliability (total alpha .856). Hence, in this study we used Creative Personality Scale consisting of 22 adjectives. Therefore, 13 checked adjectives which describe highly creative people was given a value of “+1”; 9 checked adjectives which describe less creative people was assigned a value of “-1”. The values were then summed to form a CPS index.

According to the **Tukey’s Test of Addivity**, “Climate for Creativity” variable loaded on one factor and items were averaged; but, “Leadership Styles”, “Intrinsic Motivation”, “Extrinsic Motivation” variables were taken with their factors came out from factor analysis in the following analysis. All of the factor scores in the research were calculated via averaging.

## Descriptive Statistics

**Table 3. Means, Standard Deviations, and Correlations[a]**

| Variables | Mean | s.d. | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Transformational Leadership | 4,23 | 0,61 | 1 | | | | | | | | | | | | | | |
| 2. Transactional Leadership | 4,30 | 0,61 | .607** | 1 | | | | | | | | | | | | | |
| 3. Laissez-Faire Leadership | 4,31 | 0,70 | .526** | ,696* | 1 | | | | | | | | | | | | |
| 4. Challange & Enjoyment | 3,41 | 0,56 | .533** | ,563** | ,510** | 1 | | | | | | | | | | | |
| 5. Self-Expression & Satisfaction | 3,66 | 0,41 | .385** | ,466** | ,411** | ,685** | 1 | | | | | | | | | | |
| 6. Climate for Creativity | 3,88 | 0,85 | .723** | ,721** | ,588** | ,746** | ,566** | 1 | | | | | | | | | |
| 7. Compensation | 2,20 | 0,62 | -,443** | -,317** | -,472** | -,641** | -,491** | -,665** | 1 | | | | | | | | |
| 8. Reward | 3,05 | 0,63 | -,049** | -,100** | -,035* | -,223** | -,050** | -,141** | ,270** | 1 | | | | | | | |
| 9. Acceptance | 2,31 | 0,99 | -,164** | -,363** | -,092** | -,402** | -,267** | -,394** | ,252** | ,434** | 1 | | | | | | |
| 10. Goal Setting | 3,56 | 0,50 | ,626** | ,648** | ,520** | ,645** | ,579** | ,613** | -,344** | -,044** | -,175** | 1 | | | | | |
| 11. Conservation | 6,34 | 0,59 | ,445** | ,566** | ,378** | ,392** | ,461** | ,488** | -,289** | -,082** | -,365** | ,469** | 1 | | | | |
| 12. Employee Creativity | 4,83 | 1,41 | ,512** | ,470** | ,463** | ,754** | ,479** | ,660** | -,601** | -,142** | -,227** | ,480** | ,215** | 1 | | | |
| 13. Job Tenure[b] | 9,77 | 5,47 | ,039 | ,075 | ,025 | -,078 | -,065 | ,009 | ,074 | ,096 | -,037 | ,024 | ,130 | -,070 | 1 | | |
| 14. Educational Level[b] | 14,47 | 1,47 | ,035 | ,047 | ,031 | ,069 | ,055 | ,039 | -,053 | -,031 | -,050 | ,026* | ,008 | ,046 | -,322 | 1 | |
| 15. Creative Personality | 4,14 | 1,56 | ,307** | ,272** | ,297** | ,602** | ,410** | ,428** | -,529** | -,158** | -,245** | ,294** | ,109** | ,739** | ,113** | ,042* | 1 |

[a] N=3548

[b] Job Tenure is measured in years, Education is measured in years completed in the schools

* $p<0.05$ ** $p<0.01$

Table 3 displays means, standard deviations, and correlations among all the variables. As it is seen, all variables except job tenure and educational level have correlations. Therefore only creative personality was taken as a control variable in the analysis (high correlation with employee creativity).

## Regression Analyses

To test research hypotheses, multiple regression analyses and hierarchical regression analyses were conducted. According to the correlations among the independent and mediator/moderator variables exhibited in Table 3 (and in collinearity statistics VIF values < 10), Multicollinearity was not a severe problem that would preclude interpretation of the regression analyses. Also it is determined that there is no autocorrelation since Durbin-Watson test statistics values were close to 2. In this context, stepwise regression method was executed.
Hypothesis 1 relates to the direct effect of leadership styles on employee creativity. Therefore, $H_1$ was tested using multiple regression analysis (See Table 4).

**Table 4. Summary of Multiple Regression Analysis Predicting Effects of Leadership Styles on Employee Creativity**

| *(Independent)* | Variables | Adjusted $R^2$ | F | F sig. | β | p |
|---|---|---|---|---|---|---|
| 1st Step: | Creative Personality | .545 | 4258 | .000 | .635 | .000 |
| 2nd Step: | Transformational Leadership | .635 | 3091 | .000 | .197 | .000 |
| 3rd Step: | Laissez-Faire Leadership | .639 | 2096 | .000 | .082 | .000 |
| 4th Step: | Transactional Leadership | .640 | 1579 | .000 | .070 | .001 |

*Dependent Variable: Employee Creativity*

As exhibited in Table 4, all leadership styles have effect on employee creativity and explanatory rate of the model that has 4 variables is a good explanatory power as .64. Also, it was determined that creative personality had a strong explanatory effect on employee creativity (.545). Therefore, the findings supported $H_1$, thus **$H_1$ was verified.**

Hypothesis 2 and 3 relate to the direct effect of leadership styles on employee creativity and the mediators of this relationship. To test for mediation, Baron & Kenny (1986) suggested a three-step procedure *(meditational analysis procedure)*: (a) the mediator was regressed on the independent variable, (b) the dependent variable was regressed on the independent variable, and finally, (c) the dependent variable was regressed on both the independent variable and on the mediator. However, to test for complete mediation, the independent variable needs to be controlled in the third step. In this context, full mediation occurs when the direct effect of the independent variable in this last condition is reduced to zero, otherwise the mediating effect is partial. Hence, multiple regression was performed for step one, but for steps two and three a hierarchical linear regression was employed.

**Table 5. Summary of Regression Analyses Predicting the Mediating Role of Intrinsic Motivation in the Relation between Leadership Styles and Employee Creativity**

| | Variables | Adjusted $R^2$ | F | F sig. | β | p |
|---|---|---|---|---|---|---|
| Regression 1[1a] | Creative Personality | .362 | 2012 | .000 | .469 | .000 |
| | Transactional Leadership | .534 | 2036 | .000 | .345 | .000 |
| | Laissez-Faire Leadership | .543 | 1405 | .000 | .131 | .000 |
| Regression 1[2a] | Transactional Leadership | .217 | 983,398 | .000 | .480 | .000 |
| | Creative Personality | .304 | 774 | .000 | .306 | .000 |
| | Transformational Leadership | .310 | 532,438 | .000 | -.243 | .000 |
| | Laissez-Faire Leadership | .322 | 421,696 | .000 | .163 | .000 |
| Regression 2[b] | Step 1 (exhibited in Table 4) | .640 | 1579 | .000 | .070 | .001 |
| | Step 2 | | | | | |
| | Challenge & Enjoyment | .568 | 4671 | .000 | .396 | .000 |
| | Creative Personality | .696 | 4055 | .000 | .450 | .000 |
| | Transformational Leadership | .714 | 2959 | .000 | .162 | .000 |

[1a] Dependent Variable is Challenge & Enjoyment. [2a] Dependent Variable is Self-Expression & Satisfaction.
[b] Dependent Variable is Employee Creativity.

Hypothesis 2 suggested that intrinsic motivation mediated the relationship between leadership styles and employee creativity. As shown in Table 5, the regression coefficient for intrinsic motivation's factor "Challenge & Enjoyment" was significant in contributing to employee creativity when leadership styles were controlled, indicating the mediating role of "Challenge & Enjoyment". The significance of transformational leadership decreased in step 2 whereas transactional and laissez-faire leaderships did not enter into equation, which signified that “Challenge & Enjoyment” partially mediated the relationship between leadership styles and employee creativity. Therefore, **$H_2$ was partially verified.**

**Table 6. Summary of Regression Analyses Predicting the Mediating Role of Climate for Creativity in the Relation between Leadership Styles and Employee Creativity**

| | Variables | Adjusted $R^2$ | F | F sig. | β | p |
|---|---|---|---|---|---|---|
| Regression 1[a] | Transformational Leadership | .523 | 3894 | .000 | .310 | .000 |
| | Creative Personality | .570 | 2351 | .000 | .221 | .000 |
| | Transactional Leadership | .604 | 1806 | .000 | .360 | .000 |
| | Laissez-Faire Leadership | .605 | 1360 | .000 | .047 | .003 |
| Regression 2[b] | Step 1 (exhibited in Table 4) | .640 | 1579 | .000 | | |
| | Step 2 | | | | | |
| | Creative Personality | .545 | 4258 | .000 | .554 | .000 |
| | Climate for Creativity | .690 | 3953 | .000 | .378 | .000 |
| | Laissez-Faire Leadership | .694 | 2680 | .000 | .075 | .000 |

[a] Dependent Variable is Climate for Creativity.
[b] Dependent Variable is Employee Creativity.

Hypothesis 3 suggested that climate for creativity mediated the relationship between leadership styles and employee creativity. As shown in Table 6, the regression coefficient for Climate for Creativity was significant in contributing to employee creativity when leadership styles were controlled, indicating the mediating role of Climate for Creativity. The significance of laissez-faire leadership decreased in step 2 whereas transformational and transactional leaderships did not enter into equation, which signified that Climate for Creativity partially mediated the relationship between leadership styles and employee creativity. Therefore, **$H_3$ was partially verified.**

Hypothesis 4 and 5 relate to the direct effect of leadership styles on employee creativity and the moderators of this relationship. To test for moderation, Baron & Kenny (1986) suggested moderated regression analysis: in step 1, the independent variable and the moderator were regressed on the dependent variable; then the interaction term was added into equation in step 2. They noted that if $\Delta R^2$ was significant when interaction term was entered significantly into the equation whereas the independent variable was insignificant, the moderator completely moderates this relationship; otherwise the moderating effect is partial. In addition to, following Aiken & West (1991), any variable used a component of an interaction term was centered before entering it into analysis.

**Table 7. Summary of Hierarchical Regression Analyses Predicting the Moderating Role of Extrinsic Motivation in the Relation between Leadership Styles and Employee Creativity**

| Variables | Adjusted $R^2$ | $\Delta R^2$ | F | β |
|---|---|---|---|---|
| **Step 1** | | .13** | | |
| Creative Personality | .545*** | | 4258*** | .545*** |
| Transformational Leadership | .635*** | | 3091*** | .065** |
| Compensation | .659*** | | 2282*** | -.208*** |
| Goal Setting | .672*** | | 1818*** | .130*** |
| Transactional Leadership | .674*** | | 1466*** | .130*** |
| Acceptance | .675*** | | 1227*** | .040** |
| **Step 2** | | .036* | | |
| Creative Personality | .545*** | | 4258*** | .529*** |
| Transformational Leadership | .635*** | | 3091*** | .084*** |
| Compensation | .659*** | | 2282*** | -.316*** |
| Transactional Leadership X Compensation | .686*** | | 1942*** | -.155*** |
| Transactional Leadership X Acceptance | .700*** | | 1657*** | .088*** |
| Goal Setting | .710*** | | 1446*** | .132*** |
| Transformational Leadership X Compensation | .710** | | 1244*** | -.053** |
| Transformational Leadership X Goal Setting | .711* | | 1090*** | .044* |

*p<0.05 **p<0.01 ***p<0.001

Hypothesis 4 suggested that extrinsic motivation moderated the relationship between leadership styles and employee creativity. Table 7 shows that the regression coefficient for the interaction terms between “Transactional Leadership and Compensation”, between “Transactional Leadership and Acceptance”, between "Transformational Leadership and Compensation", between "Transformational Leadership and Goal Setting" were significant, thereby confirming the moderating role of Compensation between transactional leadership and employee creativity, the moderating role of Compensation between transformational leadership and employee creativity, the moderating role of Acceptance between transactional leadership and employee creativity, and the moderating role of Goal Setting between transformational leadership and employee creativity. In addition to, results show that in the presence of compensation there is a negative relationship between transactional leadership and employee creativity and between transformational leadership and employee creativity. Hence, **$H_4$ was partially verified,** since Transformational Leadership has entered into equation significantly, whereas transactional leadership did not enter into equation in step 2.

**Table 8. Summary of Hierarchical Regression Analyses Predicting the Moderating Role of Conservation in the Relation between Leadership Styles and Employee Creativity**

| Variables | Adjusted $R^2$ | $\Delta R^2$ | F | β |
|---|---|---|---|---|
| **Step 1** | | .095** | | |
| Creative Personality | .545*** | | 4258*** | .635*** |
| Transformational Leadership | .635*** | | 3091*** | .197*** |
| Laissez-Faire Leadership | .639*** | | 2096*** | .082*** |
| Transactional Leadership | .640** | | 1579*** | .070** |
| **Step 2** | | .002*** | | |
| Creative Personality | .545*** | | 4258*** | .634*** |
| Transformational Leadership | .635*** | | 3091*** | .204*** |
| Laissez-Faire Leadership | .639*** | | 2096*** | .084*** |
| Transformational Leadership X Conservation | .640*** | | 1580*** | .041*** |
| Transactional Leadership | .642*** | | 1271*** | .078*** |

*p<0.05 **p<0.01 ***p<0.001

Hypothesis 5 suggested that conservation moderated the relationship between leadership styles and employee creativity. Table 8 shows that the regression coefficient for the interaction term between Transformational Leadership and Conservation was significant, thereby confirming the moderating role of compensation between transformational leadership and employee creativity. Therefore, **$H_5$ was partially verified,** since all of the leadership styles have entered into equation significantly in step 2.

# RESULTS AND DISCUSSION

In this study, the effects of leadership styles on employee creativity were investigated with a comprehensive model at the enterprises of Iron and Steel, Automotive and Textile industries listed in Istanbul Chamber of Industry's Turkey's Top 500 Industrial Enterprises 2008. As the results of analyses, transformational, transactional and laissez-faire leadership styles have effect on employee creativity (64%), controlling creative personality. Also results show that creative personality had a strong explanatory effect on employee creativity (54,5%). Therefore, the existence of explanatory powers of the personality on the creativity clearly supports the argument that the personality should not be ignored in the creativity and so management field. In revealing the creative behaviors that are in compliance with the terms and conditions within this context, the personality characteristics possessed by employees should be taken into consideration in the selection of employees. Hence, in this challenging world, enterprises compete with their employees because they are seen as key indicators of intellectual capital, and so important resources of gaining and sustaining competitive advantage. This study's another contribution to the creativity, leadership and management literature is, the potential mediating role of intrinsic motivation was empirically tested. Results show that, "Challenge & Enjoyment" partially mediated the relationship between leadership styles and employee creativity, and had an explanatory power 16,9%, in other words it increased employee creativity 16,9%. In addition to, mediating role of climate for creativity was empirically tested and it was seen that Climate for Creativity partially mediated the relationship between leadership styles and employee creativity, and it increased employee creativity 14,9%. On the other hand, moderating role of extrinsic motivation was tested and it was seen that Compensation partially moderated between transactional leadership and employee creativity and between transformational leadership and employee creativity; Acceptance partially moderated between transactional leadership and employee creativity, and Goal Setting partially moderated between transformational leadership and employee creativity. Results also show that Compensation had a negative association with creativity. These findings were coherent with previous research, supported extrinsic motivation factors could have both negative and positive effect on creativity changing due to situation. Finally, moderating role of

conservation was tested and it was seen that Conservation partially moderated between transformational leadership and employee creativity and it increased employee creativity 9,7%.
This study's theoretical contribution is examination of effects of leadership styles on employee creativity in a comprehensive model; proposing new mediating and moderating variables in this correlation and filling this gap in the research. Furthermore, this study's practical contribution is there is lack of research that consists of stated variables in our model conducted such a wide scope. And finally, the methodological contribution of this study is investigation of leadership styles and employee creativity in Turkey, a developing country; it shows the external validity of these theories which were developed and tested in Western developed countries.

# REFERENCES


Aiken, Leona S. and West, Stephen G. (1991), Multiple Regression: Testing and Interpreting Interactions, Newbury Park: Sage Publications, Inc.

Amabile, T. M. (1983), The Social Psychology of Creativity, New York: Springer-Verlag.

Amabile, T. M. (1988), A Model of Creativity and Innovation in Organizations, Research in Organizational Behavior, 10, 123-168.

Amabile, T. M. (1998), How to Kill Creativity, Harvard Business Review, Vol. 76(5), 77-87.

Amabile, T. M., Conti, R., Coon, H., Lazenby, J. and Herron, M. (1996) Assesing the Work Environment for Creativity, Academy of Management Journal, Vol. 39(5), 1154-1184.

Amabile, T. M., Hill, K. G., Hennessey, B. A., and Tighe, E. M. (1994), The Work Preference Inventory: Assesing Intrinsic and Extrinsic Motivational Orientations, Journal of Personality and Social Psychology, Vol. 66(5), 950-967.

Baron, R. M. and Kenny, D.A. (1986), The Moderator-Mediator Variable Distinction in Social Psychological Research: Conceptual, Strategic and Statistical Considerations, Journal of Personality and Social Psychology, Vol. 51(6), 1173-1182.

Bass, Bernard M. (1985), Leadership and Performance Beyond Expectations, New York: The Free Press.

Bass, Bernard M. (1990), From Transactional to Transformational Leadership: Learning to Share The Vision, Organizational Dynamics, Vol.19(3), 19-32.

Bass, Bernard M. and Avolio, Bruce J. (1994), Improving Organizational Effectiveness Through Transformational Leadership, Thousand Oaks, CA: Sage Publications, Inc.

Bass, Bernard M. and Avolio, Bruce J. (1995), Multifactor Leadership Questionnaire, 2nd Edition. Redwood City, CA: Mind Garden.

Boune, Louis E. and Kurtz, David L. (1990), Contemporary Business, 6th Edition. Orlando: The Dryden Press.

Burns, J. M. (1978), Leadership, New York: Harper & Row.

Cook, Curtis W., Hunsaker, Philip L. and Coffey, Robert E. (1997), Management and Organizational Behaviour, 2nd Edition. U.S.A.: Irwin-Mc GrawHill.

Deci, E. L. (1971), Effects of Externally Mediated Rewards on Intrinsic Motivation, Journal of Personality and Social Psychology, Vol. 18, 105-115.

Deci, E. L. and Ryan, R. M. (1985), Intrinsic Motivation and Self-Determination in Human Behavior, New York: Plenum.

Eisenberger, R. and Rhoades, L. (2001), Incremental Effects of Reward On Creativity, Journal of Personality and Social Psychology, Vol. 81, 728-741.

Eisenberger, R., Rhoades, L. and Cameron, J. (1999), Does Pay For Performance Increase or Decrease Perceived Self-Determination and Intrinsic Motivation?, Journal of Personality and Social Psychology, Vol. 77, 1026-1040.

Ford, C. M.,and Gioia, D. A. (1995), Multiple Visions And Multiple Voices: Academic And Practitioner Conceptions of Creativity In Organizations. In C. M. Ford & D. A. Gioia (Eds.), Creative Action In Organizations: Ivory Tower Visions And Real World Voices (pp. 3-11). Thousand Oaks, CA: Sage Publications.

Gough, H. G. (1979), A Creative Personality Scale for the Adjective Check List, Journal of Personality and Social Psychology, Vol. 37(8), 1398-1405.

Greenberg, Jerald and Baron, Robert A. (2000), Behaviour in Organisations, 7th Edition, New Jersey: Prentice Hall, Inc.

Gupta, A. and A. Singhal (1993), Managing Human Resources for Innovation and Creativity, Research Technology Management, 36, 3.

Hartog, D. and Van Muijen, J. (1997), Transactional Versus Transformational Leadership: An Analysis of the MLQ, Journal of Occupational and Organizational Psychology, Vol. 70(1), 19-25.

Jung, D. I., and Avolio, B. J. (1999), Effects of Leadership Style and Followers' Cultural Orientation on Performance in Group and Individual Task Conditions, Academy of Management Journal, 42, 208–218.

Jung, D. I. (2000), Transformational and Transactional Leadership and Their Effects on Creativity in Groups, Creativity Research Journal, Vol. 13(2), 185-195.

Kahai, S. S., Sosik, J. J., and Avolio, B. J. (1997), Effects of Leadership Style and Problem Structure on Work Group Process and Outcomes in an Electronic Meeting System Environment, Personnel Psychology, Vol. 50, 121–146.

Kahai, S. S., Sosik, J. J., and Avolio, B. J. (2003), Effects of Leadership Style, Anonymity, and Rewards On Creativity-Relevant Processes and Outcomes in An Electronic Meeting System Context, The Leadership Quarterly, Vol. 14, 499-524.

Kasof, J., Chen, C., Himsel, A., and Greenberger, E. (2007), Values and Creativity, Creativity Research Journal, Vol. 19(2–3), 105–122.

Kim, W. C., and Mauborgne, R. (2005), Blue Ocean Strategy: From Theory to Practice, California Management Review, 47(3), 105-121.

Lord, R. G. and Brown, D. J. (2001), Leadership, Values, and Subordinate Self-Concepts, The Leadership Quarterly, Vol. 12, 133-152.

Lowe, K. B., and Galen Kroeck, K. (1996), Effectiveness Correlates of Transformational and Transactional

Mumford, M. D., Scott, G. M., Gaddis, B. and Strange, J. M. (2002), Leading Creative People: Orchestrating Expertise and Relationships, Leadership Quarterly, 13(6), 705-750.

Muñoz-Doyague, M. F., González-Álvarez, N., and Nieto, M. (2008), An Examination of Individual Factors and Employees' Creativity: The Case of Spain, Creativity Research Journal, Vol. 20(1), 21-33.

Nelson, Debra L., and Quick, James Campell. (1994), Organizational Behaviour: Foundations, Realities and Challenges, U.S.A.: West Publishing Company.

Northouse, Peter G. (2001), Leadership Theory and Practice, 2nd Edition, U.S.A.: Sage Publications, Inc.

Oldham, G. R. and Cummings, A. (1996), Employee Creativity: Personal and Contextual Factors at Work, Academy of Management Journal, Vol. 39(3), 607-634.

Prabhu, V., Sutton, C. and Sauser, W. (2008), Creativity and Certain Personality Traits: Understanding the Mediating Effect of Intrinsic Motivation, Creativity Research Journal, Vol. 20(1), 53-66.

Ros, M., Schwartz, S. H. and Surkiss, S. (1999), Applied Psychology: An International Review, Vol. 48(1), 49–71.

Schwartz, S. H. (1992), Universals In The Context and Structure of Values: Theoretical Advances and Empirical Tests in 20 Countries, In M. Zanna (Ed.), Advances in Experimental Social Psychology, Vol.25,1-65, Orlando, FL: Academic.

Schwartz, S. H. (1994), Are There Universal Aspects in Values?, Journal of Social Issues, Vol. 50(4), 19-45.

Schwartz, S. H. (1999), A Theory of Cultural Values and Some Implications for Work, Applied Psychology, Vol. 48(1), 23-47.

Scott, S. G. and Bruce, R. A., (1994), Determinants of Innovative Behaviour: A Path Model of Individual Innovation in the Workplace, Academy of Management Journal, Vol. 37(3), 580-607.

Shin, S. J., Zhou, J. (2003), Transformational Leadership, Conservation, and Creativity: Evidence from Korea, Academy of Management Journal, Vol. 46(6), 703-714.

Siegel, S. ve Kaemmerer, W. (1978), Measuring the Perceived Support for Innovation in Organizations, Journal of Applied Psychology, Vol. 63, 553-562.

Sosik, J. J., Avolio, B. J., and Kahai, S. S. (1997), Effects of Leadership Style and Anonymity on Group Potency and Effectiveness in a Group Decision Support System Environment, Journal of Applied Psychology, 82, 89 103.

Sosik, J. J., Avolio, B. J.,and Kahai, S. S. (1998), Inspiring Group Creativity: Comparing Anonymous and identified electronic brainstorming. Small Group Research, 29, 3–31.

Sosik, J. J., Kahai, S. S., & Avolio, B. J. (1998), Transformational leadership and dimensions of creativity: Motivating Idea Generation in Computer-Mediated Groups, Creativity Research Journal, 11, 111–121.

Tierney, P., Farmer, S. M., and Graen, G. B. (1999), An Examination of Leadership and Employee Creativity: The Relevance of Traits and Relationships, Personnel Psychology, Vol. 52(3), 591-620.

Yukl, G. (1989). Managerial Leadership: A Review of Theory and Research, Journal of Management, Vol. 15(2), 251-289.

Yukl, G. (1992). Theory and Research on Leadership in Organizations. In: M.D. Dunnette, and L.M. Hough (Eds), Handbook of Industrial and Organizational Psychology, Vol. 3, (147-198), Palo Alto: Consulting Psychologists Press.

Yurtkoru, E. Serra. (2001), The Role of Leadership in the Organizational Change Process, Doctoral Dissertation, İstanbul: Marmara University, Faculty of Social Sciences, Discipline of Management and Organization.

Woodman, R. W., Sawyer, J. E., and Griffin, R. W. (1993), Toward a Theory of Organizational Creativity, Academy of Management Review, Vol. 18(2), 293-311.

Zhou, J., and George, J. M. (2003), Awakening Employee Creativity: The Role of Leader Emotional Intelligence, The Leadership Quarterly, 14(4-5), 545-568.

# THE EFFECTS OF LEADERSHIP STYLES AND ORGANIZATIONAL CULTURE ON FIRM'S INNOVATIVENESS

**Ethem Duygulu**
**Dokuz Eylül University, Turkey**

**Emir Özeren**
**Yaşar University, Turkey**

## ABSTRACT

*The ultimate objective of this study is to show the effects of leadership styles and organizational culture on firm's innovativeness. The study has been conducted over six different firms with a total sample size of 113 employees in order to investigate empirically the joint impact of particular leadership styles (employee orientation, production orientation, change centered leadership) and organizational culture typologies (market, hierarchy, adhocracy ,clan) on firm's innovativeness within Turkish business context. The most significant finding of the study is that adhocracy culture has been found as a common variable for all firms within the sample in explaining innovativeness. On the other side, based on firm level analysis, it has been shown that for construction and chemical firms market culture, for steel and iron firm employee oriented leadership, for pharmaceutical firm hierarchy and change centered leadership and finally for aviation firm adhocracy culture have been found to explain firm's innovativeness. Considering the departmental analysis, for production department market, hierarchy and change centered leadership, for marketing department adhocracy culture are determined as common variables in explaining innovativeness within the firm.*

**Keyword:** leadership, organizational culture, innovativeness

## I. INTRODUCTION

The main purpose of this research is to show the linkages and interrelationship among the following key variables: leadership, organizational culture, and innovation itself as one of the core dimensions of corporate entrepreneurship. We aimed to examine the effect of appropriate leadership styles and prevailing organizational culture on firm's innovativeness which itself is a significant indicator of superior performance and effective organizational outcomes. In today's contemporary business world, firms are under the great pressure of highly competitive and global markets. Under these circumstances, it is highly critical for firms to become innovative and differentiate themselves on the eyes of demanding customers in order to survive in the long run. Although there has been already a much discussion over the concept of innovation in the strategic management literature (i.e: Verganti, 2008; Siguaw and et.al, 2006), the departing point of our study from the existing literature is to examine the issue of firm's innovativeness as a dimension of corporate entrepreneurship(CE) by taking certain leadership styles and organizational culture types into consideration. As we have deeply researched the literature, the examination of innovativeness as a dimension of CE from the viewpoint of leadership styles (particularly change centered leadership) and organizational culture is a very unique approach since there are quite few studies examining the notion of firm's innovativeness in this respect. Furthermore, this research is considered to make a significant contribution to the field of strategic management for analyzing and understanding the factors which encompass both leadership styles and organizational culture types to enhance firm's innovativeness. In other words, Turkish firms which generally have a lack of strategic focus and innovative thinking will be able to learn the appropriate grounds in terms of leadership and organizational culture and build their innovation strategy upon them. The major research questions focused in our study are as follows:

1) Is there a relationship between organizational culture and firm's innovative orientation? If there is a meaningful relationship between organizational culture and firm's innovative orientation, in which organizational culture typology do employees have a perception of innovative orientation?

**2)** What kind of relationship exists between organizational leadership styles and firm's innovative behavior? What sort of impact do both organizational culture and leadership styles have on the employees' perception of innovation?

The article proceeds in the following manner. First, we briefly review the literature regarding leadership styles, organizational culture and innovation. Second, we give further details about the data collection and the statistical analyzing methods we employed within this study. Finally, we present the research findings and discuss the managerial and theoretical aspects of their strategic implications.

# II. LITERATURE REVIEW

In this section we would like to discuss briefly the theoretical background of the key variables within this study and examine the mutual relationships among these variables. The major objective of this part is to present the relevant theoretical approaches and linkages regarding leadership, organizational culture and innovativeness. First of all, we would like to begin our theoretical discussion by considering the dependent variable of our study which is "innovativeness". It should be pointed out that innovativeness was incorporated to our current research as a dimension of corporate entrepreneurship since as it is clearly stated in the literature, innovativeness is the most important and so called "sine qua non" dimension of corporate entrepreneurship. (Covin and Miles, 1999). If we want to define briefly the notion of corporate entrepreneurship, we can argue that in a broader sense, Zahra (1993) defines corporate entrepreneurship as "…a process of organizational renewal that has two distinct but related dimensions: innovation and venturing; and strategic renewal." Several authors agree with this view by indicating three components of corporate entrepreneurship: proactiveness, innovation and risk taking (Miller, 1983; Covin and Slevin, 1990). Lumpkin and Dess (1996) enlarged this definition by adding two additional dimensions to corporate entrepreneurship which are autonomy and competitive aggressiveness. Ireland, Kuratko, and Morris (2006; 10) also state that "corporate entrepreneurship is a process through which individuals in an established firm pursue entrepreneurial opportunities to innovate."

Having defined clearly what a corporate entrepreneurship is, we would like to discuss innovativeness as a core dimension of corporate entrepreneurship. Innovativeness refers to organizational wide tendency to introduce newness and novelty through experimentation and research at development of new products, services, and new processes. (Dess and Lumpkin, 2005) Innovativeness is a transformation process of a new and original idea into a new product or service which has a commercial value in the marketplace. Firms innovate in several ways, concerning business models, products, services, processes, and channels to maintain or capture markets, to outdistance competitors, and to assure long-term growth and survival, especially in highly complex and turbulent environments all of which are directly related to firm's overall strategy and enhancing strategic value of the company.

A wide range of factors has been found to affect organizational innovation. Of these, managers' leadership style has been identified as being one of the most, if not the most, important. (Jung et al, 2004) As we have discussed earlier the several meanings and definitions of innovativeness, achieving and sustaining a high level of innovativeness for the company has become an unsolved question. A more crucial concern for organizations is how to mobilize creativity among employees for the development and production of novel, socially valued products and/or services (Mumford and Gustafson, 1988, cited by Jung et al, 2004) Dess and Picken(2000) also argued that increasing work processes and evermore competitive business environment have created new challenges for organizations, and their top managers' style of leadership has accordingly become an increasingly important determinant of organizational creativity. The top management of an organization might influence employee creativity and organizational innovation in number of ways. First of all, top managers define and shape the work contexts within which employees interact to define goals, problems, and solutions (Amabile, 1998; Redmond, Mumford, & Teach, 1993, cited by Jung et al, 2004). By articulating a vision that emphasizes long-term over short-term business outcomes (e.g., growth and value rather than quarterly profit), leaders can direct employees' individual and joint efforts towards innovative work processes and outcomes (Amabile, 1996, cited by Jung et al, 2004). By creating and sustaining an organizational climate and culture that nurtures creative efforts and facilitates diffusion of learning, leaders can significantly boost organizational creativity (Yukl, 2001, cited by Jung et al, 2004). Finally, leaders can develop and maintain a system that values and rewards creative performance through compensation and other human resource related policies. When a company provides intrinsic and extrinsic rewards for efforts to acquire new skills and to experiment with creative work approaches, employees' desire to engage in creative endeavors will be constantly reinforced (Jung, 2001).

Having carefully examined the literature, we have seen that there are a number of researches examining the relationship between leadership styles or leader behaviours and creativity or innovation within organizations. For instance, Scott and Bruce (1994) found that the role expectations of a supervisor were found to have a positive influence on subordinates' innovative behavior. Tierney et al. (1999) focused on the quality of leader-follower relationship based on leader-member exchange theory, and found that it was positively related to employee creative performance. Oldham and Cummings (1996) also found that employees produced more creative work when they were supervised in a supportive, non-controlling manner. Besides, there are various research findings in the literature investigating the relationship between particular leadership styles such as transformational leadership and organization's innovative orientation. Transformational leadership is typfied as being consisted of four unique but interrelated behavioral components: inspirational motivation (articulating an appealing and/or evocative vision), intellectual stimulation (promoting creativity and innovation), idealized influence (charismatic role modeling), and individualized consideration (coaching and mentoring) (Bass and Avolio, 1994)

Howell and Avolio (1993) found a positive relationship between the intellectual stimulation provided by the leader and unit performance when there was a climate of support for innovation within the leader's unit. But when support for innovation was absent, the positive relationship became insignificant. Keller (1992) also found that transformational leadership positively influenced performance of research and development (R&D) project teams in a large R&D organization. Performance was measured based on superiors' ratings of subordinate innovativeness and the extent to which their innovative orientation added unique value to the quality of projects that they finished. (Jung et al, 2004) Aside from the traditional leadership styles which overwhelmingly focus on two major aspects of leadership concerning production(task) oriented and employee(relations) oriented, there has been a growing interest to the third type of leadership which can be referred to change centered leadership as Ekvall and Arvonen argued. Change centered leadership has gained an increasing level of popularity as a consequence of globalisation, application of new technologies, coping with a turbulent environment since there was a growing interest to adapt the organization to the changing environmental conditions.

Ekvall and Arvonen (1991, 1994) argued a change-centered leadership style, which can support the traditional relations oriented and task oriented styles while also differing from transactional and transformational leadership styles. Employee (relations) oriented leadership emphasizes interpersonal relations; taking a personal interest in the needs of employees and accepting individual differences among members (Robbins, 2003). Production oriented leaders, in contrast, tend to emphasize the technical or task aspects of the job- their main concern is in accomplishing their group's tasks and the group members are a means to that end (Robbins, 2003). According to Skogstad and Einarsen (1999), a change-centered leader encourages discussions about future possibilities, promotes new ideas for change and growth, and stimulates new projects, products and ways of doing things. Ekvall's (1991) empirical work supports change centered leadership which is active in creating and supporting renewal within organisational systems. Ekvall and Arvonen (1991) argue that change oriented leaders offer ideas about new ways of doing things, push for growth, initiate new projects, give thoughts about the future and like to discuss new ideas which are all directly related with firm's innovativeness. There was an increasing demand for a change-centered leadership style in a wide range of organizations (Ekvall and Arvonen 1991, 1994).

Having examined the different leadership styles and their relationship with firm's innovativeness, we would like to now discuss another key independent variable of our study which is organizational culture. Schein suggests that organizational culture is even more important today than it was in the past since increased competition, globalization, mergers, acquisitions, alliances, and various workforce developments have created a greater need for product innovation, strategy innovation and process innovation and the ability to successfully introduce new technologies, such as information technology. According to Schein (1985;9) we may define organizational culture as "a pattern of basic assumptions- invented, discovered, or developed by a given group as it learns to cope with its problems of external adaption and internal integration- that has worked well enough to be considered as valid and, therefore, to be taught to new members as the correct way to perceive, think and feel in relation to those problems." Organizational culture refers to the complex set of ideologies, traditions, commitments, and values that are shared throughout the organization and that influence how the organization conducts its whole performance becoming a potential source of innovation, advance and advantage. (Poškienė, 2006) Thus, cultural values and norms are a powerful means of stimulating innovation. Successful innovation may depend on organizational cultural norms that groups develop and the extent to which the group's cultural orientation aligns with, and is supported by the organization's overall orientation (Amabile, 1996, cited by Poškienė, 2006).

Having examined the existing organizational models in the literature, it would be misleading if we did not explain Quinn and his colleagues'(Quinn, 1988; Quinn and Hall, 1983; Quinn and McGrath, 1985) organizational culture framework since this framework is also closely related to different leadership roles. Accordingly, these scholars have classified organizational cultures based on two basic dimensions (internal/external orientation, and flexibility/control orientation), and developed a typology identifying four organizational cultures (group, developmental, hierarchical, and rational).

Group cultures are defined as internal and flexible in their orientation, with a tendency to people orientation within the organization. The core values are loyalty and the protection of the existing group. Developmental cultures are defined as external and flexible in their orientation, with an emphasis on dynamic creativity and adaptability, and a recognition of the importance of external clients. Hierarchical cultures are characterized as internal and control oriented, and inclined to promote values like formality, rules, clear roles and tasks, and documentation. Finally, rational cultures are described as external and control oriented, focusing on production and emphasizing values like goals and task accomplishment. (Skogstad and Einarsen, 1999)

Each culture typology is considered to have an association with different leadership roles (Quinn, 1988; Quinn and Hall, 1983; Quinn and McGrath, 1985). For instance, the description of leaders in developmental cultures corresponds to a high degree with the change-centered leadership style described by Ekvall (1991) and Ekvall and Arvonen (1991). Leaders in developmental cultures are typified as entrepreneurial, have willingness to take risks, and able to develop a vision of the future. It is generally assumed that people from a developmental culture, with its external and flexible orientation are likely to report significantly higher levels of change centered leadership when compared to those in a hierarchical culture with its strong emphasis on formality and rules. (Skogstad and Einarsen, 1999)

Cameron and Quinn (1999) have developed an organizational culture framework built upon a theoretical model called the "Competing Values Framework." This framework is based on six organizational culture dimensions and four dominant culture types (i.e., clan, adhocracy, market, and hierarchy). Accordingly, clan culture is described as a very friendly place to work where people share a lot of themselves. It is like an extended family. The organization is held together by loyalty or tradition. Commitment is high. Success is defined in terms of sensitivity to customers and concern for people. The organization places a premium on teamwork, participation, and consensus. The adhocracy culture can be characterized as a dynamic, entrepreneurial and creative place to work. The leaders are considered innovators and risk takers. The glue that holds the organization together is commitment to experimentation and innovation. Success means gaining unique and new products or services. The organization encourages individual initiative and freedom. The hierarchy culture can be defined as a very formalized and structured place to work. Procedures govern what people do. Maintaining a smooth-running organization is most critical. Formal rules and policies hold the organization together. The long term concern is on stability and performance with efficient, smooth operations. Finally, the market culture can be typified as a results oriented organization whose major concern is with getting the job done. People are competitive and goal oriented. The leaders are hard drivers and competitors. The glue that holds the organization together is an emphasis on winning. The long term focus is on competitive actions and achievement of measurable goals and targets. The organizational style is hard-driving competitiveness (Cameron and Quinn ,1999; 82).

# III. METHODOLOGY

Under the methodology section of our study, we aim to discuss the following important issues concerning the sampling frame, data collection technique and method of analysis. The sampling frame of our research consisted of employees working in six different firms. While determining these firms, the accessibility of data and convenience of data collection became our primary concerns due to time limitation. The number of questionnaires distributed to firms under consideration was 200 and the number of valid responses which were included in our study was 113. Therefore, it can be said that the narrow size of the sample constituted the major limitation of this study. The relevant data was collected through a survey instrument. The survey consists of four parts and seventy five items. The first part of the survey was composed of the questions in determining the firms' leadership styles, the second part of the survey consisted of the questions in order to explain innovativeness, the third part was constructed to describe firms' organizational culture typologies and finally the last part of the survey was designed in order to assess the demographic profile of the respondents.

The questions in the first part of the survey with regards to leadership styles was constituted based on a scale developed by Ekvall and Arvonen (1991) including thirty six items. Of these thirty six items, fourteen of them aim to measure employee orientation, twelve of them aim to measure production orientation and the rest ten items aim to measure change orientation. According to Skogstad and Einarsen (1999), compared to transformational leadership behaviours, change centered leadership are less evident in the leadership literature. The innovativeness scale of this study which was originally developed by Zahra (1993) was used based on Fiş and Çetindamar (2007) study including nine items. The underlying factor benefiting Fiş and Çetindamar (2007) study to measure firm's innovativeness is beacuse the validity of Zahra (1993) innovativeness scale was tested for Turkish literature in Fiş and Çetindamar (2007) study. The questions in the third part of the survey regarding organizational culture typologies were constructed based on Organizational Culture Assessment Instrument (a total of twenty four items) developed by Cameron and Quinn (1999) study. This instrument is based on six organizational culture dimensions (dominant characteristics, organizational leadership, management of employees, organization glue, strategic emphases and criteria of success) and four dominant culture types (clan, adhocracy, market, and hierarchy). These twenty four items were grouped on the basis of each culture typology. So, each of these four distinct organizational culture typology represents six items including organizational culture dimensions. The last part of the survey was composed of questions related with demographic characteristics of respondents concerning scope of business, age, gender, working period in particular firm, department and position details. A likert type five point scale was employed in order to measure the variables under the examination of this study. The alternative responses started from 1 representing "I never agree" to 5 representing "I absolutely agree".

To reach scientifically rigor results, instrument reliability was also established. In assessing the reliability of scales used in the questionnaire a coefficient of internal consistency was calculated using Cronbach's alpha methodology. The overall alpha for all dimensions of leadership styles was found to be 0,97 ($\alpha = .94$ for employee oriented leadership, $\alpha = .90$ for production oriented leadership, $\alpha = .90$ for change centered leadership); the overall alpha for all types of organizational culture was found to be 0,96 ($\alpha = .89$ for clan, $\alpha = .89$ for adhocracy, $\alpha = .88$ for market, and $\alpha = .87$ for hierarchy); and the overall alpha for innovativeness variable was found to be 0,93. Based on these reliability scores, it can be said that the overall reliability of the survey instrument used in this study is high.

We also employed several statistical methods for data analysis concerning correlation analysis in order to show the relationships among variables, stepwise regression and variance analysis in order to explain the causality among the variables and descriptive statistical techniques.

# IV. SUMMARY OF FINDINGS

## 1. Findings Regarding Demographic Characteristics

The employees of six different firms were included in this study. By considering their scope of business, the sample consisted of 11 respondents from construction sector, 31 respondents from steel and iron sector, 37 respondents from pharmaceutical sector, 16 respondents from aviation sector, 10 respondents from chemical industry and 8 respondents from automotive supplier industry.(a total of 113 respondents) When we examine the age profile of the respondents, we can see that 14,2 percent of all respondents (16 employees) are between 20-25 years, 32.7 percent (37 employees) between 26-30 years, 17,7 percent (20 employees) between 31 and 35 years, 7,1 percent (8 employees) between 36 and 40 years and 22,1 percent (25 employees) between 45 years and over. Based on this age profile, it can be said that young adults constituted the significant number of the sample. When we examine the gender profile of the respondents, 35,4 percent (40 employees) of all respondents are woman and 62,8 percent (71 employees) are male. Two respondents' gender data are missing.

58,4 percent of all respondents (66 employees) have a working period of 5 years and less in their organizations, 25,7 percent (29 employees) have a working period between 6 and 15 years, and 9,7 percent (11 employees) have a working period of 16 years and over in their organizations. Seven respondents did not indicate any information related with working period in organizations.

When we look at respondents' departments and positions in their respective organizations, 46 percent of all respondents (52 employees) indicated their department as production-manufacturing, R&D, quality control, and purchasing, 7,9 percent (11 employees) indicated as human resources-personnel, accounting and finance, and 41,6 percent (47 employees) indicated as marketing. 37,2 percent of all respondents constitute the lower level subordinates, whereas 60,1 percent of all respondents constitute the middle level management.

## 2. Findings Regarding Variables

Based on the demographic characteristics of the participants, we tried to explore how employees perceived the key variables of this study concerning leadership styles, organizational culture and innovativeness. Before the correlation and regression analysis among the variables, we tried to test whether there is a statistically significant difference in employees' perception of those variables with the help of Post Hoc Test-LSD. The findings of this test are summarized below.

### 2.1 The Perceptional Differences From the View Point of Firms

#### Leadership Variable (Production Orientation Dimension) :

There is a statistically significant difference in perceiving the production orientation dimension between the pharmaceutical firm and firms from other sectors. This difference occurred for construction firm (.4932, significance level at 0.03), steel and iron firm (.4287, significance level at 0.01), aviation firm (.5192, significance level at 0.01) and chemical firm (.5849, significance level at 0.01). There is no statistically meaningful difference in perceiving the production orientation dimension for automotive supplier company.

#### Leadership Variable (Change Centered Leadership Dimension) :

There is a statistically significant difference in perceiving the change centered leadership dimension between the pharmaceutical firm and steel and iron company (.3665, significance level at 0.04). We have found no statistically meaningful difference in perceiving the employee orientation dimension for entire participant firms within this study.

#### Culture Variable (For Clan Culture) :

We have found a statistically significant difference in perceiving the clan culture between the pharmaceutical firm and other firms within the scope of this study. This difference occurred for construction firm (.6511, significance level at 0.006), steel and iron firm (.4498, significance level at 0.01), aviation firm (.9304, significance level at 0.000), chemical firm (1.4450, significance level at 0.000) and automotive supplier firm (.6492, significance level at 0.01). On the other side, it was found that there were perceptual differences towards clan culture among firms themselves. For instance, there is a perceptual difference towards clan culture between chemical firm and construction firm (-.7939, significance level at 0,009), between steel and iron and automotive supplier firm (-.7958, significance level at 0.01) and between steel and iron and aviation firm (.4806 significance level at 0.02).

#### Culture Variable (For Adhocracy Culture) :

We have found a statistically significant difference in perceiving the adhocracy culture between the pharmaceutical firm and other firms within the scope of this study. This difference occurred for construction firm (.7645, significance level at 0.001), steel and iron firm (.3576, significance level at 0.03), aviation firm (.9634, significance level at 0.000), chemical firm (1.4842, significance level at 0.000) and automotive supplier firm (.7134, significance level at 0.005). Similarly, there is a perceptual difference towards adhocracy culture between employees working in the chemical firm and the construction firm (.-,7197 , significance level at 0.01), between chemical firm and steel & iron firm (-1,1265 , significance level at 0.000), between chemical firm and aviation (-,5208 , significance level at 0.04),between chemical firm and automotive supplier firm (-,7708 , significance level at 0.01).

#### Culture Variable (For Market Culture) :

We have found a statistically significant difference in perceiving the market culture between the pharmaceutical firm and other firms within the scope of this study. This difference occurred for construction firm (.7678, significance level at 0.001), steel and iron firm (.4572, significance level at 0.006), aviation firm (.7671, significance level at 0.000), chemical firm (1.5405, significance level at 0.000) and automotive supplier firm (.7072, significance level at 0.005). On the other side, it was found that there were perceptual differences towards market culture among firms themselves. For instance, there is a perceptual difference towards market culture between chemical firm and construction firm (-.7727, significance level at 0,007), between chemical firm and steel and iron firm (-1,08333 , significance level at 0.000), between chemical firm and aviation (-,7708 , significance level at 0.003), between chemical firm and automotive supplier firm (-,8333 , significance level at 0,007).

## Culture Variable (For Hierarchy Culture) :

We have found a statistically significant difference in perceiving the hierarchy culture between the pharmaceutical firm and other firms within the scope of this study. This difference occurred for construction firm (.685, significance level at 0.002), steel and iron firm (.339, significance level at 0.03), aviation firm (.695, significance level at 0.000), chemical firm (1.449, significance level at 0.000) and automotive supplier firm (.528, significance level at 0.03). Furthermore, there is a perceptual difference towards hierarchy culture between chemical firm and construction firm (-.763, significance level at 0,006), between chemical firm and steel and iron firm (-1,1098 , significance level at 0.000), between chemical firm and aviation (-,7541 , significance level at 0.003), between chemical firm and automotive supplier firm (-,9208 , significance level at 0,002).

## Innovativeness Variable :

By considering innovativeness, it was found that there was a statistically meaningful difference in perceiving the innovativeness variable from the perspective of firms which are under the scope of this study. Based on the firms perceptual differences, steel and iron firm perceive innovativeness differently when compared to construction firm (,6731 , significance level at ,008), pharmaceutical firm (-,6364 , significance level at ,000), aviation firm (,4650 , significance level at 0,04) and chemical firm (-,8682 , significance level at 0.001)

This perceptual difference towards innovativeness was found among the employees between pharmaceutical firm and construction firm (1.3095, significance level at 0.000), between pharmaceutical firm and aviation firm (1.1015, significance level at 0.000), between pharmaceutical firm and automotive supplier firm (.9876, significance level at 0.000). There was also a perceptual difference towards innovativeness among the employees between aviation firm and chemical firm (-1,333 , significance level at 0.000) , between chemical firm and automotive supplier firm (1,2194 , significance level at 0.000).

When we take into account all these perceptual differences of companies which are under the scope of this study, there appears to be a divergent view among firms in perceiving almost any variable within this research. This situation might arise from two important reasons. Firstly, firms differ in perceiving both organizational culture variable and leadership variables due to the narrow and limited size of the sample, as we have mentioned earlier. However, we should also note that the data set was found to be highly reliable based on reliability analysis. Secondly, these perceptual differences can be attributed to a number of factors such as: specific environment (customers, distributors, unions, competitors and so on) that surrounds the organization varies greatly from one firm to the other and each firm has its own unique culture, different managerial practices and uses different technologies. Given these dissimilarities, it can be said that it might be natural to observe varying degree of divergent perceptions on innovativeness among the firms. This is an important issue which is highly emphasized in the literature.

On the other side, considering the demographic characteristics such as gender, position and age, no statistically significant relationship has been found towards organizational culture and leadership styles. However, if we examine the effect of seniority on perception of innovativeness, we can see that employees working in that particular firm 5 years or less has a statistically meaningful difference in perceiving the innovativeness variable compared to those who work between 6 and 10 years (-,6718 , significance level at 0.004) and 11 years and more(-,54871 , significance level at 0.04)

One of the important findings which has been found through this research is that perceptual difference (both organizational culture and leadership) among different departments has been noted. We would like to discuss these differences in more detail below:

## 2.2 Perceptual Differences of Different Departments

Considering the leadership dimension, employees working in human resources, personnel, accounting and finance departments perceive employee oriented leadership differently when compared to employees working in production and manufacturing department (-1.06 , significance level at 0.03). Furthermore, we would like to state that marketing and sales departments have a different perception towards employee oriented leadership when compared to other departments. (-1,226 , significance level at 0.01)

In a similar vein, employees working in human resources, personnel, accounting and finance departments perceive production oriented leadership differently when compared to those working in production and manufacturing department ( -,8597 , significance level at 0.04), marketing and sales departments have a different perception towards production oriented leadership than another departments. (-1,149 , significance level at 0.005) Considering the change centered leadership, it has been found that a statistically meaningful difference in perceiving the change centered leadership exists between marketing, sales and other departments concerning human resources, personnel, accounting, finance (1,069 , significance level at 0.01).

Considering clan culture, marketing departments perceive clan culture differently compared to human resources-personnel, accounting, finance departments ( ,963 , significance level at 0,03). For adhocracy culture, marketing department perceive adhocracy culture differently from production department (,399 , significance level at 0.04) and human resources-personnel, accounting, finance departments (1,294 , significance level at 0.004) Considering market as one of the organizational culture typologies, marketing department perceive market culture differently when compared to human resources, personnel, accounting, finance(,866 , significance level at 0.04) and production-manufacturing (,518 , significance level at 0.01) Considering hierarchy culture as the one of the organizational culture typologies, there is a difference in perception between marketing department and other departments concerning human resources, personnel, accounting, finance (1,127 , significance level at 0.008)

Besides, innovativeness variable is perceived differently between marketing and production department (,751 ,significance level at 0.001) Under the light of relevant scientific evidence, in order to explain the innovativeness variable by showing the effects of different organizational culture typologies and leadership styles, the step wise regression variance analysis was made and the relationships among the variables were constructed below.

## 2.3. The Relationships Among The Variables

We have conducted a stepwise regression analysis in order to explain the effects of certain leadership styles and organizational culture typologies on innovativeness variable. The results demonstrated that innovativeness variable is explained by the adhocracy culture for the entire sample as shown below in Table 1.

**<u>Table 1:</u> Innovativeness Variable, Stepwise Regression Analysis**
(for the entire sample)

| Model 1 | R | $R^2$ | B | Std. Error | Beta | t | Sig |
|---|---|---|---|---|---|---|---|
| adhocracy [a] | ,490(a) | ,240 | ,538 | ,096 | ,490 | 5,618 | ,000(a) |
| F:31,563<br>a Predictors: (Constant), adhocracy<br>Other variables did not come into the analysis. | | | | | | | |

By interpreting the figures shown above in **Table 1**, the innovativeness variable is explained by adhocracy culture with an explanatory percentage of 24 %. This means that twenty four percent of firm's innovativeness can be explained with the help of adhocracy culture. This finding is consistent with the literature since adhocracy culture emphasizes greatly the development of new and creative ideas which strengthens the likelihood of innovativeness within an organization. Adhocracy culture is also related with finding new markets, focusing on achievement and generating creative solutions to existing problems. It is important to keep in mind that having this kind of organizational culture might facilitate firms' innovation capability. When we look at the major characteristics of this organizational culture typology, it can be easily seen that openness to change come to the forefront in adhocratic organizations. Leaders are innovative, creative, risk taking and future oriented in organizations driven by the adhocracy. For this reason, change centered leadership is assumed to place a great emphasis on adhocratic cultures.

As we have discussed earlier, we have found paramount differences in perceiving culture and leadership dimensions on the basis of firm level and departmental level. Therefore, it is crucial to be able to explain the underlying factors lying behind the innovativeness from the viewpoint of both firm and departmental level of analysis.

The regression analysis results of firms are presented in **Table 2.** Accordingly, innovativeness in construction and chemical firms is explained by market culture. Innovativeness in aviation sector could be explained with the help of adhocracy culture which is also consistent with the literature since Cameron and Quinn (1999) pointed out that adhocracy organization may frequently be found in industries such as aerospace, software development, think tank consulting and film making. Innovativeness in pharmaceutical firm is explained by the hierarchy culture whereas innovativeness in steel and iron firm is explained by employee oriented leadership. These results could also be checked from Table 2.

**Table 2 : Stepwise Regression Analysis of Firms (Model Summary)(f)**

| Firms | Model | R | R Square | F | Sig |
|---|---|---|---|---|---|
| Construction | 1 | ,826(a) | ,682 | 19,337 | ,002(a) |
| Steel and iron | 1 | ,732(b) | ,536 | 23,104 | ,000(b) |
| Pharmaceutical | 1 | ,559(c) | ,313 | 15,912 | ,000(c) |
| | 2 | ,641(d) | ,411 | 11,846 | ,000(d) |
| Aviation | 1 | ,654(e) | ,428 | 8,977 | ,011(e) |
| Chemical | 1 | ,632(a) | ,400 | 5,329 | ,050(a) |

f Dependent Variable: innovation
a Predictors: (Constant), market
b Predictors: (Constant), employee orientation leadership
c Predictors: (Constant), hierarchy
d Predictors: (Constant), hierarchy, change centered leadership
e Predictors: (Constant), adhocracy

**Table 2a: Coefficients According to Firm Level of Analysis (a)**

| Firms | Model | | Unstand, Coefficients | | Stand. Coefficients | | . |
|---|---|---|---|---|---|---|---|
| | | | B | Std. Error | Beta | t | Sig |
| Construction | 1 | (Constant) | -,244 | ,724 | | -,337 | ,744 |
| | | Market | ,902 | ,205 | ,826 | 4,397 | ,002 |
| Steel and iron | 1 | (Constant) | 1,546 | ,444 | | 3,479 | ,002 |
| | | Employee orientation leadership | ,564 | ,117 | ,732 | 4,807 | ,000 |
| Pharmaceutical | 1 | (Constant) | 1,183 | ,754 | | 1,569 | ,126 |
| | | Hierarchy | ,708 | ,178 | ,559 | 3,989 | ,000 |
| | 2 | (Constant) | 1,625 | ,732 | | 2,220 | ,033 |
| | | Hierarchy | 1,086 | ,230 | ,858 | 4,715 | ,000 |
| | | Change centered leadership | -,517 | ,217 | -,433 | -2,379 | ,023 |
| Aviation | 1 | (Constant) | ,504 | ,888 | | ,568 | ,580 |
| | | Adhocracy | ,830 | ,277 | ,654 | 2,996 | ,011 |
| Chemical | 1 | (Constant) | 3,448 | ,422 | | 8,179 | ,000 |
| | | Market | ,357 | ,155 | ,632 | 2,308 | ,050 |

a Dependent Variable: innovation

By interpreting the figures shown in Table 2a, we can say that a quite strong and positive relationship has been found between market culture and innovativeness particularly in construction and chemical firms. This can be easily seen from Beta coefficients. Based on these results, it is likely to say that these firms are achievement oriented and seek to maximize their profit in new markets with the help of aggressive strategy. As a result of being achievement oriented and aggressive in the marketplace, the leadership approach in these organizations is assumed to be based on aggressive, result (outcome) oriented focus. Leaders heavily rely on hitting stretch targets and winning in the marketplace. When we consider the results of pharmaceutical firm, it might be seen that the innovativeness variable is explained by two phased model. In the first model, innovativeness variable is explained by the hierarchy whereas in the second phase change centered leadership is incorporated into the model and it is important to keep in mind that there is an inverse relationship between change centered leadership and hierarchy culture.

Another considerable finding for the pharmaceutical firm is that as the change centered leadership comes into the model, beta coefficient in explaining the innovativeness increases. Such rise in beta value shows us the explanatory power of change centered leadership on innovativeness. This is a significant finding demonstrating that there is a strong desire for change in the organization. The finding is also relevant and consistent from the viewpoint of literature. Since Skogstad and Einarsen (1999) stated that change centered leadership encourages discussions about future possibilities, promotes new ideas for change and growth, and stimulates new projects, products and ways of doing things. Therefore, it can be said that change centered leadership establishes a ground for the innovativeness within the organization. On the other side, it has been found that a strong and positive relationship exists between employee oriented leadership and innovativeness for the steel and iron company. Considering the production process of steel and iron, we might say that it relies heavily on technology and a complex specific environment. Given this background, employee oriented leadership emphasizes interpersonal relations; taking a personal interest in the needs of employees and accepting individual differences among members (Robbins, 2003). From the viewpoint of aviation firm, a strong and positive relationship exists between adhocracy culture and innovativeness.

**Table 3: Stepwise Regression Analysis Based on Departments**
**Model Summary(e)**

| Department | Model | R | R Square | F | Sig. |
|---|---|---|---|---|---|
| Production | 1 | ,532(a) | ,283 | 5,527 | ,034(a) |
| | 2 | ,746(b) | ,557 | 8,156 | ,005(b) |
| | 3 | ,869(c) | ,755 | 12,332 | ,001(c) |
| Marketing | 1 | ,531(d) | ,282 | 28,643 | ,000(d) |

a Predictors: (Constant), market
b Predictors: (Constant), market, hierarchy
c Predictors: (Constant), market, hierarchy, change centered leadership
d Predictors: (Constant), adhocracy
e Dependent Variable: innovation

**Table 3(a): Coefficients(a) Based On Departments**

| | | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|---|
| Department | Model | | B | Std. Error | Beta | B | Std. Error |
| Production | 1 | (Constant) | ,766 | 1,107 | | ,692 | ,500 |
| | | Market | ,741 | ,315 | ,532 | 2,351 | ,034 |
| | 2 | (Constant) | 3,035 | 1,208 | | 2,513 | ,026 |
| | | Market | 1,626 | ,405 | 1,167 | 4,017 | ,001 |
| | | Hierarchy | -1,458 | ,515 | -,823 | -2,831 | ,014 |
| | 3 | (Constant) | 2,529 | ,948 | | 2,667 | ,021 |
| | | Market | 1,605 | ,313 | 1,152 | 5,126 | ,000 |
| | | Hierarchy | -1,839 | ,417 | -1,038 | -4,413 | ,001 |
| | | Change Centered Leadership. | ,532 | ,171 | ,500 | 3,119 | ,009 |
| Marketing | 1 | (Constant) | 1,725 | ,399 | | 4,320 | ,000 |
| | | Adhocracy | ,577 | ,108 | ,531 | 5,352 | ,000 |

a Dependent Variable: innovation

Now that we would like to discuss the results of the regression analysis on the basis of departments. The details of this analysis is shown above in Table 3. Accordingly, two departments which are production and marketing come to the forefront for explaining the innovativeness within the organization Considering the production departments of firms, we see three phased approach in explaining the innovativeness. According to first model, market culture explains the firm's innovativeness. In the third model, when "hierarchy" and "change centered leadership" get involved into the model, the explanatory power of the model increases by 75 percent. On the other side, as obviously seen from the associations among the variables, an inverse relationship exists between hierarchy and market culture whereas a positive relationship between change centered leadership and market culture has been noted. Another remarkable finding is that adhocracy culture has been the leading variable to explain the innovativeness in marketing departments of all firms within the sample.

# V. CONCLUSION

Having taken all relevant findings into consideration, we may conclude that organizational culture has "sui generis" characteristics. This study once again proved that each organization has its own organizational culture. Even though the research has been conducted with a limited sample size, the clear cut differences in perceptions confirm us the uniqueness of organizational culture. The most significant finding of the study is that adhocracy culture has been found as a common variable for all firms in explaining innovativeness. Furthermore, it can be seen that the explanatory power of organizational culture on innovativeness is more important when compared to leadership. This is partly due to the fact that organizational culture is holistic, evolves over time and relies heavily on permanent behavioral patterns.

Even though it is generally voiced that it is very difficult to measure organizational culture, using an appropriate and reliable scale facilitates the measurement of organizational culture dimensions and drawing significant conclusions regarding organizational culture. The instrument we employed within this study to determine firm's organizational culture profile has been rarely tested and studied empirically. Therefore, we believe that the current study will also be beneficial for identification of firm's organizational culture. Our study will also open a new path for further research examining the relationship between organizational culture typologies (market, clan, adhocracy, hierarchy), change centered leadership style and firm's innovativeness. On the other side, it would be misleading if we ignore the effect of leadership styles on firm's innovativeness.

One of the biggest contributions of this study is to highlight an issue of third leadership dimension which is change centered leadership. More importantly, firm's innovativeness could only be understood if leadership and organizational culture are jointly evaluated. For instance, if we want to explain the innovativeness of production department by market culture solely, only 28 percent of production department's innovativeness could be attributed to market culture. Instead, if we explain the innovativeness of the same department with market, hierarchy and change centered leadership together, the explanatory power of the model increases up to 75 percent. Therefore, organizational culture typologies and leadership styles should be taken into analysis together in order to understand the real determinants of innovativeness.

Considering the limitations of this study, upper level of statistical analysis (such as structural equation modeling, path analysis and confirmative factor analysis) seems to be necessary for further research in order to arrive more generalizable results.

By extending the sample size, the determination of implicit variables in the model will contribute significantly to the current literature. We should also indicate that one of the significant findings of this study is that production oriented leadership has not been found in any analysis regardless of firms. In other words, production oriented leadership was not perceived as significant by employees in any firm within the sample. This is an important signal in the management literature showing that there is an ongoing shift and orientation towards organic processes. It can be said that employees have expectations of contemporary approaches from their top management. Especially during the era of an economic crisis just as we experience now throughout the world, need for a new paradigm seems to be inevitable. Under these circumstances, today change is the natural state in most organizations and thus leadership is more focused on renewal and change and less on stable efficiency (Sellgren et al, 2006). This can only be achieved through a new leadership behavior which focuses on change within the firm. This new way of leadership can be seen as a combination of three leadership dimensions which are employee orientation, production orientation and change centered leadership. The current developments in management and organization call for a new style of leadership so called change centered leadership. The need for change in organizations seems to be met via change oriented leaders since they offer ideas about new ways of doing things, push for growth, initiate new projects, give thoughts about the future, like to discuss new ideas which eventually lead to firm's innovativeness (Ekvall and Arvonen, 1991). Based on Hofstede (1980) and Schwartz (1999) cross cultural studies, Turkey was found to be a collectivistic culture whereas this study reveals a strong emphasis on adhocracy culture and thereby change centered leadership in organization settings which can also be evaluated as an evidence for need of change culture which may lead the researchers to investigate as a further research topic.

# REFERENCE


Bass, B.M., & Avolio, B.J. (1994). Improving organizational effectiveness through transformational leadership. Thousand Oaks, CA: Sage.

Cameron, K.S., and Quinn, R.E. (1999). *Diagnosing and Changing Organizational Culture: Bases on the Competing Values Framework,* Addison Wesley Publishing Company

Covin, J. G. & Slevin, D. P. (1990). New venture strategic posture, structure, and performance:

Covin, J. G., Miles, M. P. (1999) Corporate Entrepreneurship and The Pursuit Of Competitive Advantage. *Entrepreneurship Theory and Practice*, 23(3): 47–63.

Dess, G.G. and Lumpkin, G.T. (2005). "The Role of Entrepreneurial Orientation in Stimulating Effective Corporate Entrepreneurship," *Academy of Management Executive,* 19(1), 147-156

Dess, G.G., and Picken, J.C. (2000). Changing roles: Leadership in the 21st century. *Organizational Dynamics,* 29(4), 18-33

Ekvall, G. (1991). Change-centered leaders: Empirical evidence of a third dimension of leadership. *Leadership and Organization Development Journal, 12,* 18-23 Francisco: Jossey-Bass Publishers.

Ekvall G. & Arvonen J. (1991) Change centered leadership. An extension of the two dimensional model. *Scandinavian Journal of Management* 7, 17–26.

Ekvall G. & Arvonen J. (1994) Leadership profiles, situation and effectiveness. *Creativity and Innovation Management 3* (3), 139–161.

Fiş, A., and Çetindamar, D. (2007) Girişimcilik Oryantasyonu, Kurum İçi Girişimcilik ve Bağlı Ölçeklerin Türkçe'de Geçerlemesi, 15. Ulusal Yönetim ve Organizasyon Kongresi Bildiriler Kitabı, p:124-132

Hofstede, G. (1980). Culture's Consequences: International Differences in Work Related Values, Beverly Hills, Ca: Sage Publication

Howell, J.M., & Avolio, B.J. (1993). Transformational leadership, transactional leadership, locus of control and support for innovation: Key predictors of consolidated-business-unit performance. Journal of Applied Psychology, 78, 891-902.

Ireland, R. D., Kuratko, D. F., Morris, M. H. (2006). A health audit for corporate entrepreneurship: Innovation at all levels, Part I. *Journal of Business Strategy*, 27(1), 10-17.

Jung, D. (2001). Transformational and transactional leadership and their effects on creativity in groups. *Creativity Research Journal,* 13, 185-195.

Jung, D.I., Chow, C. and Wu, A. (2004). The Role of Transformational Leadership in Enhancing Organizational Innovation: Hypotheses and Some Preliminary Findings, San Diego State University Center for International Business Education and Research(CIBER), Publication No. C04-002

Keller, R.T. (1992). Transformational leadership and the performance of research and development project groups. *Journal of Management,* 18, 489-501.

Lumpkin, G. T. & Dess, G. C. (1996). Clarifying the entrepreneurial orientation construct and linking it to performance. *Academy of Management Review*, 21(1), 135.

Miller, D. (1983). The correlates of entrepreneurship in three types of firms. *Management Science*, 29(7), 770-791.
Oldham, G.R., & Cummings, A. (1996). Employee creativity: Personal and contextual factors at work. *Academy of Management Journal,* 39, 607-634.

Poškienė, A. (2006). Organizational Culture and Innovations, *Engineering Economics, 1(46) ISSN 1392-2785*

Quinn, R. E. (1988). *Beyond rational management*: *Mastering the paradoxes and competing demands of high performance*. San Francisco: Jossey-Bass.

Quinn, R. E., & Hall, R. H. (1983). Environments, organizations, and policy makers: Toward an integrative framework. In R.H. Hall, & R.E. Quinn (Eds.), *Organization theory and public policy*: *Contributions and limitations*. Beverly Hills, CA: Sage Publications.

Quinn, R. E., & McGrath, M. R. (1985). The transformation of organizational culture: a competing values perspective. In P. J. Frost, M. R. Moore, C. C. Lundberg, & J. Martin (Eds.), *Organizational culture* (pp. 315}334). Beverly Hills, CA: Sage.

Robbins, S. (2003). *Organizational Behavior.* Pearson Education, Inc., Upper Saddle River, Tenth Edition

Schein, E. H. (1985). *Organizational culture and leadership*. San Francisco: Jossey-Bass.

Scott, S.G., & Bruce, R.A. (1994). Determinants of innovative behavior: A path model of individual innovation in the workplace. *Academy of Management Journal,* 37, 580-607.

Schwartz, S. (1999). A Theory of Cultural Values and Some Implications for Work, Applied Psychology: An International Review, 48 (1), 23-47

Sellgren, S., Ekvall G., and Tomson, G. (2006). Leadership styles in nursing management: Preferred and perceived, *Journal of Nursing Management,* 14, 348–355

Siguaw J. A., Simpson P.M., and Enz C.A. (2006). Conceptualizing Innovation Orientation: A Framework for Study and Integration of Innovation Research, *The Journal of Product Innovation Management,* 23:556-574

Skogstad A. and Einarsen S. (1999). The importance of a change-centred leadership style in four organizational cultures, *Scandinavian Journal of Management,* 15, 289-306

Tierney, P., Farmer, S.M., & Graen, G.B. (1999). An examination of leadership and employee creativity: The relevance of traits and relationships. *Personnel Psychology,* 52, 591-620.

Verganti R. (2008). Design, Meanings, and Radical Innovation: A Metamodel and a Research Agenda, T*he Journal of Product Innovation Management,* 25: 436-456

Zahra, S. A. (1993). A conceptual model of entrepreneurship as firm behavior: A critique and extension. *Entrepreneurship Theory and Practice***.** 17(4), 5-22

Zahra, S.A. (1993). Environment, corporate entrepreneurship, and financial performance: A taxonomic approach. *Journal of Business Venturing* 8(4):319–340.

# A QUALITATIVE STUDY OF KEY SUCCESS FACTORS FOR MULTINATIONAL CORPORATIONS OPERATING IN SUB- SAHARAN AFRICA

**A.C. Parker,**
**J. Hough**
**E.W. Neuland**
**Stellenbosch University, South Africa**

## ABSTRACT

*"Africa's not for sissies" is what one often hears when discussing doing business in sub-Saharan Africa (excluding South Africa for purposes of this study). The region boasts some of the lowest human development index scores and economic growth levels in the world, while enjoying the unenviable reputation as one of the most corrupt places on earth.*

*The fact that SSA fares poorest of all when it comes to attracting Foreign Direct Investment, with barely 1% of global inflows (UNCTAD, 2007.World Investment Report), is due to foreign investor perceptions of unacceptable country risk that keep them from investing here. Reasons for SSA's malaise are instructive as context for the status quo and include the aftermath of colonialism, continued flare-ups of ethnic-induced civil unrest, the lingering effects of a disastrous flirtation with socialism and a recent generation of corrupt and incompetent leaders.*

*However, the good news is that the new millennium increasingly exhibits significant trends in support of the notion that a reversal of SSA's fortunes is underway: annual GDP growth in the region is well ahead of the global average, civil wars in the region have largely come to an end and, for two years running, private equity investment flows into the region have surpassed that of foreign aid, Africa's traditional 'crutch'.*

*Importantly, a small band of early-mover Multinational Corporations (MNCs) are making their presence felt in the region and beginning to make good profits. These firms include the likes of Diageo, The Coca-Cola Company, MTN and SABMiller.*
*Still, today's business environment in the small, impoverished markets of SSA remains extremely challenging, characterised by poor infrastructure and skills, coupled to an unhelpful officialdom.*

*The purpose of this research is to unpack the impediments to investing in SSA, both real and imagined, and then to discuss ways of overcoming these. By applying a qualitative research methodology, including the use of case studies and structured interviews with executives of the MNCs active in the region, key success factors for investing and operating in the region will be identified and explained.*

## 1. INTRODUCTION

This study focuses on how the affiliates of selected Multinational Corporations (MNCs) deal with the opportunities and risk factors that exist in the sub-Saharan region of Africa (SSA).

Evidence presented in this paper suggests that sub-Saharan Africa (SSA) represents an interesting business opportunity for MNCs in search of growth, especially for those willing to explore the market segment at the base of the economic pyramid (BOP). It further suggests that the challenging business environment of the region may be effectively overcome by firms that are well prepared and willing to adapt to local needs.

The study also highlights the current opportunity that exists in the region for firms setting out from South Africa, who, being African and based in Africa's most dynamic economy, should have an advantage over MNCs from the rest of the world (Brews, 2006: 379).

The set of key success factors (KSFs) developed from the research results could serve as practical tool for application by firms already present in the region, as well as those preparing to enter SSA for the first time. Due to the advantages accruing to early mover entrants, a degree of urgency considering new investments in the region, is suggested for firms although as Fanus Nothnagel correctly points out, the window of opportunity for early movers into SSA will remain open for an extended year or two as result of the current global financial crisis which is forcing MNCs to focus inwards at restructuring their business models, rather than investing in new high-risk markets.

# 2. RESEARCH METHODOLOGY

## 2.1. THE RESEARCH PROBLEM AND QUESTIONS

Mouton (2008: 48) describes the first phase of a research project as the transformation of an interesting idea into a "feasible, researchable research problem". The research problem has been formulated as follows: "Sub-Saharan Africa (SSA)'s unattractive business environment has, until now, largely prevented MNCs from investing in the region, when compared to their presence in the rest of the developing world."

According to Mouton (2008: 53), "Research problems implicitly or explicitly embody a research question". In this instance, three questions flow from the research problem:

- As stated by Hill (2005: 218), when it comes to FDI, Africa is by far the worst performing region on the globe. Secondary research has identified those environmental factors that result in the region being viewed in negative light by international investors. So, why aren't MNCs targeting Sub-Saharan Africa with the same fervour as they do when it comes to the likes of Asia, Eastern Europe and South America?
  For purposes of the study of MNC affiliates operating in SSA, this question has been rephrased into the following two-part question: What are the real impediments experienced in doing business in SSA, and why have those MNC affiliates present in the region decided to do business there despite these difficulties?

- Grobbelaar (2006: 35) states that a number of companies have demonstrated beyond any doubt that good business can be done on the continent. This fact leads to the next question: How are those MNC affiliates present in the region, able to overcome the challenges of SSA in order to earn good profits?
  Put into terms used in this study, this question is phrased as follows: What are the Key Success Factors (KSFs) that have allowed early-mover MNC affiliates to achieve success in SSA?

- Luiz (2006: 9), estimates that SSA accounts for 17% of the world's poor, with just about 800 million inhabitants earning US$650 per capita annually, while 48% live on less than US$1 a day. Collectively, this represents a large untapped market opportunity. Brews (2006: 382), however, cautions that a serious challenge facing rich country entrants into Africa is "whether their existing products, services or solutions are even saleable or scaleable in the continent."
  Therefore, the final question to be considered is whether it is possible for MNCs to commercially explore the considerable potential that exists at the base of the economic pyramid (BOEP) in SSA.

## 2.2. THE RESEARCH OBJECTIVE

In this instance, the primary aim of the research is to alert potential investors to the considerable opportunities (and challenges) that exist in the region, including the identification of strategic and operational guidelines that may enhance their chances of being successful.

## 2.3. RESEARCH DESIGN

The specific research design elements included in this study are:

Primary research elements:

- Face-to-face and telephonic interviews with senior executives of MNC affiliates operating in the region will provide fresh insights and empirical proof of the reasons for entering SSA, operational difficulties encountered and the existence of KSFs currently employed in order to overcome these challenges.
- A compilation of case studies of MNC affiliate successes achieved in the region will illustrate how these KSFs are being implemented as well as their impact on business results.
- Observations by the author based on his personal experience and interaction with peers during 15 years spent as the head of SABMiller plc's operations in SSA. These observations are centred on the KSFs employed by MNC affiliates in the region, but also include views about the state of the region's business environment.

Secondary research elements:

- An analysis of existing literature on the business environment in SSA. Although there's a paucity of formal publications on the subject, more recent interest in the region has resulted in a number of articles now being published on a regular basis in reputable publications.
- A scan of current international business literature in order to complement and validate the above observations by the author.

## 2.4. THE EMPIRICAL RESEARCH STUDY

The target population of the empirical research element was the affiliates of MNCS who have a meaningful presence in sub-Saharan Africa and proven track record of supplying branded goods and services to consumers in the region.

The sample has been structured to include:

- MNC affiliates head-quartered in different countries (UK, USA and South Africa);
- fast-moving consumer goods manufacturers (soft drinks, milk, beer & spirits);
- service providers (banking, advertising and mobile phone call time);
- retailers.

A total of 18 senior executives, representing 11 MNCs, were interviewed.
\

# 3. RESEARCH FINDINGS

## 3.1. INTRODUCTION

The research findings may be grouped under the following headings:

- An evaluation of the role and conduct of multinational corporations (MNCs) in the global economy
- An analysis of the true state of the business environment in sub-Saharan Africa(SSA)
- Identification of the Key Success Factors (KSFs) applied by MNC affiliates operating in SSA.

## 3.2. THE ROLE OF MULTINATIONAL CORPORATIONS (MNCs)

As this dissertation is focussed on the behaviour and experiences of the affiliates of MNCs in sub-Saharan Africa, it was deemed essential to conduct a thorough examination of the subject matter of the MNC, in order to serve as context when evaluating the modus operandi of this enterprise-type in the region. Hence, the definition of the key characteristics of the modern-day MNC, as well as tracing its origins and emergence as arguably the most dominant enterprise at work in today's global economy.

The literature review found that firms that expand into international markets are able to generate profitable growth in ways not available to domestic firms, including the realization of location and scale economies, as well as leveraging their core competencies by rolling out these skills to new markets (Hill,2005: 416). The emergence of the MNC as a dominant force in the global economy has come about as an appropriate and efficient reaction by business to the globalisation trend that has swept the world, particularly post - World

War Two. The establishment of the Bretton Woods institutions should be viewed as an enabling factor towards creating a more conducive environment for the growth of MNCs.

The growth of MNCs has gone hand in hand with the rising tide of globalisation that has gathered momentum post-World War Two. It is clear that the debate that surrounds the impact of globalisation as force for good versus the negative views of its detractors is by no means over. Behrman's expression of the need for MNCs and other key players to compromise and search for trade-offs in order to extend the positive outcomes of the process, especially to the world's poorer nations, has relevance (Behrman,2006: 440)

## 3.3. THE TRUE STATE OF THE BUSINESS ENVIRONMENT IN SUB-SAHARAN AFRICA (SSA)

**3.3.1. Conditions are difficult, but certainly not impossible**

The MNC executives interviewed during the empirical research process gave the lie to the following description of SSA, which is often still held by commentators not intimately involved in the region:"The prospect of investing in sub-Saharan Africa can cause businessmen to sweat. The region is often seen as a corporate graveyard of small, impossibly difficult markets where war, famine, AIDS and disaster are always lurking" (The Economist, "The flicker of a brighter future", 2006: 65).

On the one hand, all respondents agreed that serious impediments to doing business in the region do exist, especially in the areas of infrastructure and local skills. However, these are not impossible to overcome, as proven by examples provided in the set of KSFs and case studies included in the study. All MNCs and their affiliates active in the region have successfully developed mechanisms to cope with the region's tough business environment and there's every reason to believe that determined and well-equipped newcomers will be able to follow in their footsteps.

SABMiller's Mark Bowman further believes that the risk of moving into high-risk markets may be offset by building up a portfolio of investment spread across the region. "There is risk to moving in early, but the portfolio effect should take care of the impact on overall l results".
All MNCs and their affiliates active in the region have successfully developed mechanisms to cope with the region's tough business environment and there's every reason to believe that determined and well-equipped newcomers will be able to follow in their footsteps.

**3.3.2. Corruption**

The view of the majority of respondents was captured by Jacko Maree, CEO of Standard Bank, who put the much-vaunted spectre of corruption in perspective by commenting that dealing with corruption is not such a big issue when operating in SSA and points out that other banks such as Citibank and Barclays have been operating in the region for many years, without having to employ corrupt practices. "Corruption exists in most countries, including South Africa, but you simply have to turn down opportunities that involve this type of unacceptable behaviour."

**3.3.3. Profit potential**

On the other hand, SSA's profit potential is usually under-estimated by those not familiar with the region. This view was well-represented by David Hampshire who commented that being able to see the potential of Africa becoming a key contributor to Guinness's world-wide earnings, despite an environment that was often hostile, was critical. David's experience was that this insight was generated from within their African business, in their case, by their own expatriates seconded to Africa. He had to expend considerable effort in order to convince his 'masters' from headquarters and members of the board of the extent of Africa's potential.

In fact, Rob Nisbet believes that MTN has lost substantial profits due to the growth in demand exceeding their wildest expectations. "From an overall demand perspective, we always underestimate the size of the market. If we had been better at this from the start, you'd probably find that our bottom line profitability would today be 15 – 20% better as a result of market share losses sustained due to capacity constraints".

Nick Blasquez adds sage advice to investors in SSA: "Diageo's long and profitable history in Africa has contained its fair share of ups and downs which has taught us the value of being patient during the bad times." Nathan Kambulu further believes that Africa is really making progress, reporting that The Coca-Cola Company is optimistic about its future and willing to invest in the capacity of its business on the continent.

Africa's potential is often hid from outsiders, but well known to those with operations on the continent, as illustrated by the following comment from SABMiller's Graham MacKay: "If there was more of Africa, we'd be investing in it" (The Economist, "The flicker of a brighter future",2006: 65).

## 3.4. THE KEY SUCCESS FACTORS (KSFs) APPLIED IN SSA BY MNC AFFILIATES

**3.4.1. It's 'business as usual' plus**
"Doing business in Africa is not business as usual. The principles of good management may be universal, but the context and the people differ profoundly in Africa" (Luiz, 2006: 391). The set of Key Success Factors (KSFs) identified from the research results should not come as any surprise to MNCs with operations throughout the developing world. The proper use of expatriates, focus on execution, investing ahead of demand and the like are standard fare for developing markets from Cameroon to China.

Even the following commentary from Faull (2006: 317) may be applied to most developing markets: "It is often noted that business in Africa is characterised by 'deal making' rather than process excellence. Deal making is most common in situations of uncertainty. And in Africa there are many sources of uncertainty, or so it has been over the past 50 years......Even aid, of which Africa is the hungriest continent, can be seen to be about deal making. However, sustained progress for Africa must be built on sustainable process excellence: being a reliable partner in a local and global trading environment cannot be based on 'deals'. Many of the uncertainties (infrastructure, rule of law, health care) have process as the core counter measure, and it is a sobering thought that both the private sector in Africa and the public servants in Africa will have to shift from 'deal making' to process reliability or certainty to deliver long-term value to their 'customers'."

However, the arena requiring fresh insights and solutions has been described by Hart and Christensen (cited in London & Hart, 2004) as the mounting pressure on MNCs to create a more inclusive capitalism, including a greater role in addressing global societal issues such as eradicating poverty and environmental protection in developing countries. Although observers will note that this too, represents a global challenge to big business, it is of particular relevance in the poorest continent on the globe, possessed with a past of being exploited by colonial and super powers alike.

The two KSFs listed below that deal with this issue are headed 'making trade-offs in order to share the benefits (and burdens)' and 'partnering with government'. Both are particularly relevant to those wishing to do business in the region, bearing in mind that the results of this research represent a work in progress.

**3.4.2. The Key Success Factors identified**
The set of Key Success Factors (KSFs) identified from the research results should not come as any surprise to MNCs with operations throughout the developing world. The proper use of expatriates, focus on execution, investing ahead of demand and the like are standard fare for developing markets from Cameroon to China.

The research study identified the following:

Strategic KSFs
- Defining an appropriate strategy and business model.
- Making trade-offs in order to share the benefits (and burdens)
- Partnering with Government
- Bulking up for critical mass
- Capturing the opportunity at the base of the economic pyramid

Operational KSFs
- Using expatriates effectively
- Flawless execution
- Investing ahead of demand

Four case studies were prepared, illustrating the Key Success Factors as applied by MNC affiliates in SSA:

- MTN's Nigerian entry
- The privatisation of Tanzania Breweries Ltd to SABMiller
- Kenya Breweries Ltd's introduction of Senator Keg
- The turn-around of Coca-Cola Sabco's Ethiopian bottler

**3.4.2.1. Defining an appropriate strategy and business model**

The challenge for MNCs is to blend their global recipe for success with local flavour in order that the operating unit may capture the best of both worlds when meeting the challenges of any particular country. Put differently, they need to find a balance between the need to lower the cost of value creation on the one hand and being able to differentiate its product and service offerings to best meet consumer needs within a local context on the other. The former requirement is best served by standardisation of processes and products, the establishment of best practice communities within the organisation and greater central control, while the latter is best met through a decentralised business model that values having capable and autonomous in-country executives and lets them 'get on with it'.

The MNCs represented in the empirical research study generally follow or strive towards Hill's definition of a transnational strategy: "In essence, firms that follow a transnational study are trying to simultaneously achieve low costs through location economies, economies of scale and learning effects; differentiate their product offering across geographic markets to account for local differences; and foster a multidirectional flow of skills between different subsidiaries in the firm's global network of operations" (Hill,2007: 429 – 430).

In terms of implementing the appropriate business model in order to pursue a transnational strategy in SSA, it was significant to find that the respondents interviewed were overwhelmingly in favour of a decentralised approach, the very different markets and trying surroundings that these affiliates operate in, elevating the need for local responsiveness above the pressure for cost reductions.

**3.4.2.2. Making trade-offs in order to share benefits**

De Soto (as cited in London and Hart,2004) argues that entering low-income markets in emerging economies generally requires a different strategic approach in that the MNC has to bridge both the formal and informal economies, with relationships in the latter being grounded primarily on social, not legal, contracts. Organisations that value and manage to leverage existing social capital have achieved success in these markets (London and Hart,2004: 352). Hart and Christensen (also cited in London and Hart, 2004) go even further in observing that the pressure on MNCs to create a more inclusive capitalism is mounting, including a greater role in addressing global societal issues such as eradicating poverty and environmental protection in developing countries.

Apart from behaving as a responsible corporate citizen, including investing in worthy community projects, MNCs are also able to send a telling signal that their presence in a country is not merely another round of colonialism dressed up as FDI, by reserving a meaningful share in the affiliate for local participation, ideally through a listing on the local stock exchange where one exists. In addition, the affiliate should further actively encourage *outsourcing* suitable business activities to local entrepreneurs, including former employees. As a result, not only is the affiliate then viewed in a positive light by local stakeholders, but it also receives a further sharing-dividend in the form of local knowledge and influence being integrated into its activities on the ground.

As far as can be ascertained, all MNC affiliates participate in corporate citizenship investments to a greater or lesser degree, much like the example of The Coca-Cola Company (TCCC) for whom community involvement is a feature of their operations in Africa, especially in the areas of water conservation, fighting HIV/Aids and eradicating malaria. TCCC also provides water through sinking boreholes in rural Ethiopia and Kenya.

However, the research did unearth a best-in-class example that has been set by MTN who, apart from giving monetary support to deserving causes through the MTN Foundation, actively involves its staff members across the company's 21 operations in Africa and the Middle East, who embark on a month-long '*Y'ello Care* programme', a volunteerism campaign that involves every employee in community building projects. According to the results of the empirical research conducted, there is widespread support amongst MNCs and their affiliates for the need to communicate well with government. Whereas it is a fact that the lack of resources and undeveloped nature of the infrastructure in most SSA countries may be extremely challenging, the converse also holds true in that it creates opportunities for the local MNC affiliate to partner with government in arriving at 'win/win' solutions to mutual problems.

**3.4.2.3. Partnering with government**

Grobbelaar (2006:48) notes that quite often, services that would normally be supplied by national and local governments are so deficient that MNC affiliates have to take these on as a coping mechanism, for example:

- installing their own water purification plants and sewerage farms;
- sinking their own boreholes;
- building roads and water pipelines;
- providing back-up power generation;
- contracting additional security.

Taking on these projects may be costly, but the affiliate reaps multiple rewards in the form of a more efficient operation, improved relations with government and favourable perceptions by the community at large.

**3.4.2.4. Bulking up for critical mass**

A fundamental obstacle that stands in the way of any business wishing to invest profitably in a typical SSA country is that of constrained market size. Jaco Maree, CEO of Standard Bank, mentions that "building a really big business consisting of lots of little units is hard work".

An appropriate strategy for MNCs and their affiliates operating in poor countries such as those of SSA, is to extract maximum return from each of their positions, without unfairly exploiting the consumer or host country in the process, or else the investment may simply not be worth the effort. Many examples of current best practise in Africa were discovered.

**3.4.2.5. Capturing the opportunity at the base of the economic pyramid (BOEP)**

Base of the economic pyramid markets, consisting of the billions of aspiring poor who are joining the market economy for the first time, have been described by Prahalad and Hart (as cited by London & Hart, 2004) as the new untapped source of market promise. However, capturing the opportunity that exists at the base of the economic pyramid is virtually uncharted territory for MNCs and academics alike (Ricart et al,2004: 194).

The empirical research results provide an affirmative answer to the research question formulated as whether it is possible for MNCs to commercially explore the considerable potential that exists at the base of the economic pyramid in SSA. Quite a number of successful examples were uncovered, from MTN building a US$ billion-plus company in Nigeria on the back of small domination pre-paid call cards, to SC Johnson's success with mosquito-repellent coils in Ghana and Nigeria, sold one coil at a time.

MNCs included in the research study have proven that it is possible to explore this difficult-to-reach segment of the market, although they're nearer the beginning than the end in their ability to do so consistently.

**3.4.2.6. Using expatriates effectively**

Adler and Ghadar (cited in Shay and Baak,2004) suggest that MNCs use expatriates as a source of control, assigning them to ensure consistency between headquarters and affiliates in terms of strategy, managerial practices and operational policies.

However, it is as facilitator of knowledge transfer between affiliates and with headquarters that an expatriate has the greatest potential role to play. The leveraging of knowledge across borders is at the centre of the theory of the MNC. Horizontal FDI occurs because of the transfer of knowledge within the firm and across borders – these transfers are the primary expression of the growth of firms. To the extent that a firm has developed procedures by which to codify knowledge for the benefit of external users, the easier it is to transfer technology to unaffiliated parties (Kogut and Zander,1993: 632,639).

Findings from the empirical research study confirm the reliance of MNCs on the use of expatriates in their SSA affiliates. It should, however, be noted that local resentment against expatriates commonly occurs when the MNC uses the latter to actually run the affiliate indefinitely, without serious commitment to the often difficult process of localisation – an easy trap to fall into, especially in Africa given its limited talent pool. The expatriate contract should be clear: it is to *p*ass on knowledge, train and develop local successors, after which the expatriate moves onto his next secondment. It is when MNCs break this contract that they invite the ire of the host country. "In the early years of globalisation, we had to use US expatriates. They were critical to our successful start, but we were having trouble getting off this crutch" (Welch,2001: 314). General Electric's corrective action was based on localisation programmes by business that included quantified targets.

**3.4.2.7. Flawless execution**

Doing well in Africa requires relentless focus on executing well – doing it right every time. Poor infrastructure, skills shortages and the need to adapt to local circumstances, among others, all contribute to an extremely challenging environment. The ability to execute flawlessly is valued above all else, even above the smartest strategies and the best laid plans.

A decentralised business model represents an appropriate response to the execution challenge. However, it's not a matter of merely decentralising decision making in order to execute well. A globally-proven set of robust systems and processes combined with an effective performance management system that includes benchmarking against the best in class, are essential precursors in order for a decentralised business model to work effectively for any MNC.

**3.4.2.8. Investing ahead of demand**

This particular KSF was not discovered during the literary review exercise, but has been included as result of a common theme emerging from the empirical research study. Some of SSA's most prominent MNCs have warned against an understandable, but costly mistake: that of not investing in sufficient production capacity in order to meet the increased demand when a business lifts off from its relatively small consumer base.

This is a common mistake to make in the early days after entering a new market because:

- The market potential is difficult to define as a result of the paucity of consumer-related information, including the impact of the substantial informal sector in these markets.
- New investors are naturally reticent to invest more than the minimum until they develop the confidence that comes from proven business successes, which takes some time to occur.

The cost of not meeting demand can be enormous, as was discovered in the case of MTN.

# 4. SCOPE AND LIMITATIONS OF THE RESEARCH

## 4.1. THE FOCUS ON MNC AFFILIATES

Empirical research was conducted among MNC affiliates who have a meaningful presence in sub-Saharan Africa(SSA) and proven track record of supplying branded goods and services to consumers in the region. The sample was structured to include:

- MNC affiliates head-quartered in different countries (UK, USA and South Africa)
- Fast-moving consumer goods manufacturers (soft drinks, milk, beer & spirits)
- Service providers (banking, advertising and mobile phone call time)
- Retailers.

It is further important to note that the study was focussed on the behaviour of the affiliates or subsidiaries of MNCs, as opposed to MNC headquarters. This distinction is consistent with the observation by Phene and Almeida (2008: 902) that: "given this importance of the subsidiaries to MNC success, researchers are increasingly examining subsidiary performance."

## 4.2. A PANEL OF EXPERTS

Personal interviews were conducted with a selected convenience sample of 18 senior executives (current or past Managing Directors of affiliates or regions) of the MNCs included in the study. In limiting the research to a relatively small group of top executives (as opposed to a larger sample that would necessitate including middle-management), the author was swayed by the earlier plea from Tsui (2004: 508) for the need to build new theories of management and organisations in emerging economies where businesses are new phenomena. This goal is best achieved by gaining the views from a panel of experts: those at the very top of their organisations who have a complete view of all the complexities of doing business in the region, from strategy all the way through to the most mundane of operational challenges.

## 4.3. SOUTH AFRICA EXCLUDED

The geographic area studied was that of SSA which is defined as Africa minus the North African countries of Algeria, Egypt, Libya, Morocco, Sudan and Tunisia (UNCTAD, 2008: 2). It was chosen as the economic region under review because it is poor, undeveloped and under-researched. This makes it topical and worthy of further research, as endorsed by the following authors:

- Studies by Hart and Milstein, as well as Prahalad and Hart (cited in London and Hart, 2004) show that a growing number of MNCs are now beginning to recognise and explore the enormous business opportunity that exists at the base of the economic pyramid (BOEP), of which SSA forms a significant part.
- However, almost no empirical research exists on strategies for pursuing opportunities in low-income markets in developing countries (London and Hart, 2004: 351).
- Tsui (2004:497) argues that in order to advance global knowledge, more context-specific or indigenous research is needed.

For purposes of this study, the South African market, and therefore MNC affiliates operating in that country, has been excluded from the SSA countries, because it has a relatively well-developed economy and possesses a business-friendly environment, characterised by good infrastructure and business skills.

In fact, BusinessMap Investment (cited in Grobbelaar, 2006) found that South Africa is fast becoming a major source of Foreign Direct Investment into the rest of the SSA region. It should come as no surprise, therefore, that many of the MNCs and senior executives included in the research study hail from South Africa.

## 4.4. THE LITERATURE REVIEW

Results drawn from the extensive review conducted of international business literature on the subject of developing economies, including SSA, may justifiably be regarded as being representative of current theories held by academics in the field of international business. As may be seen from the bibliography, which contains over a hundred references, a wide range of international business literature was reviewed by the researcher.

The secondary research component was, however, hampered by the paucity of business research amongst the economies of SSA is severe, partially as a result of the lack of interest in the region as displayed to date by international investors. Smit (2006: foreword) comments that “Africa is seen as the last untapped market for business education in the world. The need for business education here is almost boundless.” So for SSA-specific business literature, much reliance was placed on the content of one publication: Luiz’s (2006) ‘Managing Business in Africa’ which, although an excellent reference work, cannot purport to be fully representative of business developments throughout the region, apart from being somewhat dated.

## 4.5. LIMITATIONS OF THE EMPIRICAL RESEARCH RESULTS

Because the empirical research study was restricted to only 18 senior executives from 11 MNC’s operating in the SSA region, as defined for purposes of this study, it allowed for the capture of in-depth knowledge and thought regarding the business challenges faced in SSA. On the other hand, however, the limited sample of respondents surveyed means that the results of this study cannot be taken as being representative of all firms operating in the region.

## 4.6. RECOMMENDATIONS

The following suggestions for further research are aimed at extracting full value from the results derived from this study:

- In order to overcome the limitation of not being able to replicate the current research results, one should test the support for the Key Success Factors identified in this study amongst a representative sample of MNC affiliates operating in the region.

- Because the governments of SSA countries are such key influencers of the business environment in which firms have to operate, it would be useful to conduct research amongst governments of the region in order to ascertain their views of FDI, private enterprise behaviour and the potential for government partnering with business to the benefit of society at large.
- Due to the unquestioned promise of BOEP markets on the one hand, coupled to the new challenges facing firms wishing to explore these markets commercially on the other, further case studies of commercial success achieved in this market segment would go a long way towards giving more firms the confidence of extending their activities to this market segment.
- Because expatriates are so important to the MNC cause in SSA, but are also often regarded with suspicion by host countries, a separate research study on the subject of the use of expatriates in the region would be of value to a wide range of stakeholders.
- As Nigeria represents SSA's largest economy (excluding South Africa) and is a closed book to most MNCs not invested there, research of the business environment prevailing in that country would help open it up to possible further FDI-flows from MNCs.

# REFERENCES


Behrman,J.N. 2006. A career in the early limbo of international business: policy, research and education. *Journal of International Business Studies*, 37(3): 432 - 445.

Brews,P.J. 2006. Strategy and Strategic management in Africa. *In* Luiz,J.M. (ed.) *Managing business in Africa: practical management theory for an emerging market*. Cape Town: Oxford University Press. P. 365 – 386.

Faull,N. 2006. Operations and logistics management. *In* Luiz,J.M. (ed.), *Managing business in Africa: practical management theory for an emerging market*. Cape Town: Oxford University Press. p. 311 – 344.

Grobbelaar,N 2006.The trading and investment environment in Africa. *In* Luiz,J.M. (ed.), *Managing business in Africa: practical management theory for an emerging market.* Cape Town: Oxford University Press. p. 32 – 58.

Hill,C.W.L. 2007. *International Business: competing in the global marketplace*. Sixth edition. New York: McGraw-Hill/Irwin.

Hill,C.W.L. 2005. *International Business: competing in the global marketplace*. Fifth edition. New York: McGraw-Hill/Irwin.

Kogut,B. and Zander,U. 1993. Knowledge of the firm and the evolutionary theory of the multinational enterprise. *Journal of International Business Studies*,24: 625 - 646.

Luiz,J.M. 2006.Challenges and prospects for economic and business development in Africa. *In* Luiz,J.M.(ed.), *Managing business in Africa: practical management theory for an emerging market* Cape Town: Oxford University Press. p 3 – 30.

Luiz,J.M. 2006.Mastering the environment of business in Africa. *In* Luiz,J.M. (ed.) *Managing business in Africa: practical management theory for an emerging market*. Cape Town: Oxford University Press. p. 387 – 391.

London,T. and Hart,S.L. 2004. Reinventing strategies for emerging markets: beyond the transnational model. *Journal of International Business Studies*,35(5): 350 - 370.

Mouton,J. 2008. *How to succeed in your Master's & Doctoral studies – a South African guide and resource book*. Pretoria: Van Schaik.

Phene,A. and Almeida,P. 2008. Innovation in multinational subsidiaries: the role of knowledge assimilation and subsidiary capabilities. *Journal of International Business Studies,* 39(5): 901 – 919.

Ricart,J.E., Enright,M.J., Ghemawat,P., Hart,S.L. and Khanna,T. 2004. New frontiers in international strategy. Journal of International Business Studies, 35(3): 175 - 200.

Shay,J.P. and Baack,S.A. 2004. Expatriate assignment, adjustment and effectiveness: an empirical examination of the big picture. *Journal of International Business Studies*, 35(3): 216 – 232.

The Economist: "*The flicker of a brighter future*." 9th September,2006: 65-67.
Tsui,A.S. 2004. Contributing to global management knowledge: a case for high quality indigenous research. *Asia Pacific Journal of Management*, 21: 491 – 513.

UNCTAD. 2007.*World Investment Report*. Available: http://www.unctad.org (accessed 20th March,2008).

Welch,J. and Byrne,J.A. 2001. *JACK. What I've learned leading a great company and great people.* London: Headline Book Publishing.

# STRATEGIC ALLIANCES AND THE IMPACTS OF STAR ALLIANCE NETWORK ON TURKISH AIRLINES

**Özlem Atalık**
**Ali Halıcı**
**Anadolu University, Turkey**

## ABSTRACT

*The air transportation sector has witnessed a number of changes since the deregulation processes of the US industry (in the 1980s) and of the European industry (in the 1990s). These changes include the substantial decline in the number of major carriers, the intensified reorganization of routes into hub-and-spoke networks and, still taking place, the formation of strategic alliances among international carriers. (Morrison, Winston 1995, Flores-Fillol, Moner, 2005) In recent years, an increased strategic alliance among airlines has been a major trend in the air transport sector. Full mergers, strategic alliance,s code-sharing agreements and block-seat sales are examples of the variety of cooperation forms that have been used by airlines. Consequently strategic airline alliances are an important topic in airline management and marketing today. This paper presents a case study of international strategic alliance -which is outstanding subject for Turkish Airlines (THY) these days- between Star Alliance Network and Turkish Airlines. This paper begins to defining the airline strategic alliances, their variations, reasons, benefits and the evaluation of their impacts and then followed by a description of the present status of alliance between Turkish Airlines and Star Alliance Network. It concluded as giving the answers for the questions like; what are the impacts of this strategic alliance on THY and THY customers?*

## INTRODUCTION

Alliances were traditionally confined to peripheral businesses and marginal markets, however, today, ownership of all the skills and resources required to exploit market opportunities is increasingly difficult to achieve (Hamel and Doz, 1998). A number of key trends are stimulating the emergence of newer forms of business relationships: increasing globalization and the internationalization of markets; a blurring of the distinction between product and services marketing; the emergence of telecommunications and computing, with the resultant increase in both information and communication; the quickening pace of change; the disintermediation of markets; the emergence of network competition; knowledge- based not product-based organizations; and the merging of marketing strategy with corporate strategy. Responding expeditiously to these changes has become imperative (Burdett, 1991). Alliances have at least three distinct purposes; co-option, that is turning competitors into allies through collaboration; co-specialization, that is combining existing resources, skills, and knowledge into value and learning and internalization, that is the development of core competencies through a learning alliance (Doz and Hamel, 1998, Bretherton 2003)

Nonetheless during the last decade "strategic alliances" dominated both the corporate world and the international management literature, as a "business model." Strategic alliances, which are becoming an increasingly important management strategy for the future, represent a cooperative and complementary approach to achieving market reach; drive customer loyalty, supplement operational capability and help drive down costs (Stickler, 2001, Semercioz, Kocer, 2004)

There may be several reasons as pointed out in the strategic management literature Oum, Park and Zhang (2000) have observed that there is no universally term as "a long term partnership of two or more firms who attempt to enhance competitive advantages collectively vis-à-vis their competitors by sharing scarce resources including brand assets and market access capability, enhancing service quality, and thereby, improving profitability." They have then extended it to practical application as, "In practical terms, a strategic alliance is one involving strategic commitment by top management to link up a substantial part of their respective route networks as well as collaborating on some key areas of airline business." Membership of an international alliance has become a key component of business strategy for many airlines. (Goel, Uncles, 2003)

According to another definition, “A strategic airline alliance is a long term partnership of two or more firms who attempt to enhance advantages collectively vis-a` -vis their competitors by sharing scarce resources including brand assets and market access capability, enhancing service quality, and thereby improving profitability. A strategic alliance is one involving strategic commitment by top management to link up a substantial part of their respective route networks as well as collaborating on some key areas of airline business.” (Iatrou, Alamdari: 2005)

The International Air Transport Association (2001) defines an airline alliance as follows: three or more airlines participating in commercial relationship or joint venture, where a joint and commonly identifiable product is marketed under a single commercial name or brand; and this commercial name or brand is promoted to the public through the airlines participating in the alliance and its agents; and the commercial name or brand is used to identify the alliance services at airports and other service delivery points in situations where bilateral agreements exist, e.g., code share agreement.

According to Abeyratne, (2000) the underlying philosophy of the airline alliances, typified by a “Star” Alliance, is not so much an emphasis on the more effective use of resources such as labour, capital and national resources (which are inevitably important factors) but rather an overall reliance on the strategy of location, where the sharing of locations represented by the various airlines have enabled them to produce their goods and services in a consistent manner, thus achieving the status equivalent to a cartel, while still retaining their individual identities. Airlines have developed both a corporate strategy and a competition strategy to cope with competition. Both these strategies are becoming increasingly complementary rather than being mutually exclusive, which they were at the inception of airline competition 50 years ago. As airlines began to compete with each other across the borders, they acquired the ability to locate themselves overseas—creating a compelling need for commercial airlines to be fully acquainted with locational strategy and competitive advantages of various locations.

## Important Reasons for Global Alliances

The body of opinion suggests that there are five generic reasons for entering into a strategic alliance: (Bennett, 1999)

**1.To achieve economies of scale and learning:** Thayer (1994) contends that the concept of the strategic alliance is rooted in the notion that complementary partners can achieve economies of scale. Unquestionably, a prime motive for collaboration amongst airlines is to improve profitability. This is achieved through shared airport facilities, combined sales operations, etc., in combination with an extended network. Economies are gained through elimination of duplication and a reduced workforce. There are also economies to be derived from marketing in terms of both advertising and code-sharing. Acquiring new skills and learning from the operations of another more successful company are also recognised motivators (Hamel *et al.*, 1989). Arguably, this generic reason could be extended to include economies of scope on the basis that airlines are extending their marketable networks through franchising, code-sharing, block spacing and equity stakes in other airlines (Hanlon, 1996).

**2. To gain access to the benefits of the other firm’s assets:** Due to the regulatory framework of bilaterals and capacity restrictions combined with the start-up costs of operating on a new route, an alliance can offer relatively easy Access to a route. Congestion is a particular problem both in the sky and on the ground in that slots and gates at many airports are at maximum capacity. With the additional obstacle of grandfather rights, access to the market can be difficult. Allying with another airline also reduces costs in terms of the supply of aircraft to operate on a route. Access to products is therefore as significant in many respects as access to market.

Linked to both is the human resource issue in that an alliance surmounts the hurdle of restructuring or mobilising the workforce, an acknowledged concomitant of expansion. Access to the market is also important. Harrigan (1992) states that ‘lower regulatory barriers are opening up the door for a variety of firms to enter formerly protected markets through joint ventures’. This factor helps explain the strategic alliances between European and US airlines, which to date form the majority of partnerships, in that a US partner provides access to the world’s biggest domestic market (accounting for approximatley 40% of the world aviation market) while a European partner provides a link into the newly liberalised aviation market. The latter is significant due to heavy congestion at major European airports such as Heathrow.

**3. To reduce risk by sharing it:** There can be little doubt that setting up an operation on a route is a high-risk strategy, particularly if such an operation adds capacity. Such additional competition can lead to efforts by incumbent airlines to protect their market, resulting in price wars and predatory pricing. An alliance with an airline already operating a route reduces the risk. It also means that the incumbent airline is exposed to less competition. Given the small size of many markets together with the costs involved in operating a route, collaboration can assist airlines in lowering costs and encouraging profitability. Given the lack of profits of the airline industry in recent years, there can be little doubt about the high risk nature of this sector. Indeed, perhaps the best example of collaboration in this sector due to such risks is the collaborative venture between Boeing and Airbus to develop a superjumbo which can carry up to 1000 passengers.

**4. To help shape the market, e.g. withdrawal of capacity in a mature market:** This is crucial to understanding airline alliances. Overcapacity is an acknowledged problem, one solution being to reduce the number of airlines. By collaborating through alliances, airlines are, in effect, reducing the competition. Sabena, for example, actively views its blocked space agreements as a means of reducing express capacity (CAA, 1994). Equally, in the alliance between KLM and Northwest only one service is offered on each Amsterdam– US route even though two services are shown in the timetable. In the alliances between major and regional airlines in the United States, a significant outcome has been a decline in competition (Williams, 1993).

**5. Speed in reaching the market:** There are two major structural changes which are affecting the airline industry. The first is deregulation. The protection afforded by regulations which have been endorsed by governments (usually with a vested interest in 'flag' carriers) is gradually giving way to free competition. Such deregulation has already occurred in the aviation markets of the United States, New Zealand, Australia and Canada. Within the US, which accounts for 40% of the aviation market, the situation has been reached whereby five carriers hold 95% market share between them. Within the European Union liberalisation is not due to be completed until April 1997, at which time member states will be permitted to fly freely within the EU. Recent alliance formation with and between EU airlines is directly attributable to the fact that in 1997 the skies of the EU will be 'open'.

A twin engine of deregulation is privatisation. Governments of developed nations are under increasing financial and political pressure to relinquish control of their 'flag' carriers with the result that collaboration between airlines of different nations becomes not only possible but inevitable. The airlines of southern Europe which are heavily loss-making have been kept aloft by hefty and highly controversial payments of state aid authorised by the Union. With the EU policy on state aid of 'one time, last time', such troubled carriers as Olympic, Alitalia and Iberia will look for partners, preferably stronger ones, to ensure their future existence. For example, while Iberia is a loss-maker, it does have Access to slots at Madrid's congested airport; similarly Alitalia is an 'attractive' partner in that it is a major shareholder in Aeroporti de Roma, Rome's primary airport, which monopolises ground services.

Underpinning this need to reach the market is globalisation. The changes taking place in the airline industry are fostering global competition which poses difficulties for airlines wanting to expand or go it alone. To secure a place in the aviation market of the future, a presence is needed in the six major markets: North America, Pacific, Europe and the markets between them.

This globalisation of the marketplace is a major force driving alliances (Ohmae, 1989) in that strategic alliances enable airlines to compete on a global scale by offering extensive route networks. Certainly, it is a commonly held belief that by the turn of the century only a handful of mega-carriers will exist. The pressure therefore exists for airlines to consolidate their positions if they are to survive into the next century.

**6. Survival**: In addition to the five 'traditional' reasons for alliance formation, a sixth can be added, that of survival. This is particularly pertinent to the airline industry where losses have become commonplace and where in Europe liberalisation unfolds fully in 1997. Consequently, attention is largely focused on Europe where alliances are increasing in number.

## Benefits of Airline Global Alliances

Then, Oum et al. (2000) focus on the airline industry and identify the following as the most common and most important benefits to form strategic alliances:

**Reach of Seamless Service Networks:** A connection of networks gives the consumers a large choice of destinations to choose from and plan better, connections are eased out and there are increased benefits of Frequent Flyer Programs (they have a broader range of benefits to offer) and lesser possibilities of lost baggage. Also, the alliances' network comes in handy when operations are to be made in highly competitive, unprofitable and price sensitive market conditions (e.g. pooling in of resources by two airlines to coordinate to overcome otherwise unprofitable routes). By connecting the networks, partners are able to expand their routes beyond their country territories. Also, there are several restrictions on foreign ownership and fifth, seventh and eighth freedom rights are generally not available. Even if some carriers manage to get the requisite legal permissions, the costs associated -of time, risk and capitalact as virtual barriers (potential facilitators) to direct entry by foreign airlines in other markets (for forming strategic alliances).

**Enhanced Traffic Feed**: With linkage of the airline networks the carriers can increase their load factors with the increased feed. Also, flight frequency can be increased without increasing the size of the fleet.

**Cost Reduction**: The partners in the alliance can have the benefits of attaining the economies of scale (through joint operations of air and ground services) and scope (through increased reach and efficient connections) and increased traffic density (through network expansion and additional traffic feed).

**Service Quality Improvement**: Ease of online connections, frequency and schedule convenience has been marked as the dimensions of an airline's service quality. By entering into alliances, the schedules can be better-coordinated and waiting time for passengers reduced. Further, the increase in itinerary choices is another benefit that an alliance can offer to passengers.

**Marketing Advantages**: The frequent flyer programs are pooled in an alliance and the passengers thus have a wider choice as well as more chances to accrue points to use later. Then there are many display benefits of Computerized Reservation System for airlines entering into strategic alliances. The visibility on the CRS is increased manifold as all the partners in the alliance show the flight to the same destination as their own. Consequently, the chances that a traveller will fly a particular airline are increased manifold. (Burton, Hanlon, 1994) Increased market share and cooperative pricing that is possible is another reason that airlines enter into strategic alliances. There have been concerns raised over time about the anti-competitive effects of the alliances; there have been exemptions like KLM Northwest alliance, which received anti-trust immunity. This is reportedly one of the reasons that Netherlands became the first country to sign an Open Skies pact with the US.

As Doganis (1994) has also observed that the larger airlines offer the FFP members more opportunities to collect and use points. They may also act as a potential entry barrier for small start-ups. In addition, they provide access to information on passenger characteristics and needs and also direct marketing access to large number of frequent travellers. The data as provided in the same paper suggests that there is high non-redemption rate that offsets the potential huge costs that the airlines may have to incur in flying passengers for "free".

Another reason to enter into alliance has been put forward by de Wit (1996), where he finds alliances a convenient way to form a multiple hub structure. This multiple hub structure will give the alliance an edge over any other airline that wishes to operate in Europe. A pan European alliance or an alliance dominant in Europe will be an attractive partner that will be sought to become one of the members of a global alliance. This is also one of the identified pre-requisites of a potential partner willing to join a global network (Oum, Taylor and Zhang, 1993).

## Types of Airline Alliance

Over the years a very wide range of complex inter-airline agreements has grown up to meet specific airline needs. As present the most prevalent form of alliance in the airline industry is code-sharing agreements. Although a co-operation can take many forms, most forms are combined with a code-sharing arrangement. Conceptually, the diversity of alliances can be related to the level of cohesion between the code-sharing partners. This level is reflected in (Berechmank, Joseph and Jaap de Wit, 1999, Chang –Hsu, 2005):

- The network scope
- The commercial commitment of the non-operating carrier(s) in the alliance
- The degree of integration of the other components of the marketing mix
- The operational integration of the airline product
- Equity aspects of the alliance

Generally speaking, there are four types of alliance. The simplest is the point specific, in which airlines only code-share or blockspace purchase on certain city pairs as was the case with Qantas and Swissair, which used to code-share between Australia and Switzerland via Singapore. Another case is Air China, which has a blockspace agreement with Finnair on the Helsinki-Beijing route.

The second type is the regional alliance, in which airlines code-share on several routes or franchise regional airlines. For example, Ansett and KLM are intercontinental route partners, which code-share between Sydney, Brisbane, Canberra, Melbourne, Adelaide and Cairns. Japan Airlines and Iberia have a code-share agreement on intra-European flights between Madrid, Barcelona and Amsterdam. Australia's domestic airline Impulse served as Qantas's franchise partner.

The third type is the global alliance, in which airlines code-share vast numbers of routes, linking two major hub networks, in a wider commercial agreement. One example is Singapore Airlines, Thai Airways, All Nippon Airlines, Air New Zealand and Ansett, which are Star Alliance partners in Asia-Pacific. Cathay Pacific and Qantas are Oneworld's partners in this region.

The last type is the strategic alliance. According to Professor Doganis (Doganis, 2001), a strategic alliance is one where the partners co-mingle their assets in order to pursue a single or joint set of business objectives. Co-mingled assets may be terminal facilities, maintenance bases, aircraft, staff, traffic rights or capital resources. If two or more airlines offer a common brand and a uniform service standard then they are co-mingling their assets and have moved into a strategic alliance. Many franchise agreements are of this kind. British Airways' franchise agreement with Maersk Air UK, Comair, Loganair and Base Airlines are examples of this type of alliance.

## Most Prominent International Airline Alliances

The first international alliance was formedin 1986 between Air Florida and British Island. Air Florida fed US originating traffic to code-shared British Island's flights on the London-Amsterdam route. The past experience of airline alliances has clearly been one of great instability. Many alliances have been abandoned because of management difficulties and/or the divergence of carriers' needs and interests. (Chang –Hsu, 2005) And then most airlines participate in some form of strategic alliance (Gallacher, 1999a; O_Toole, 2000). In July 1994, there were more than 280 alliances between 136 airlines (Airline Business, 1994). Six years on, in July 2000, this number had grown to 579 alliances between 220 airlines (Airline Business, 2000). The view is that airlines that do not participate in alliances will be severely disadvantaged (Mak and Go, 1995; Li, 2000), and carriers left out of major alliances may find themselves forced into becoming niche players (Oum and Park, 1997, K. Goh, Uncles, 2003) As predicted by several researchers global alliance networks have begun to form. Currently, there are 3 prominent global alliance groups in airline industry

**Star Alliance:** The Star Alliance network was established in 1997 as the first truly global airline alliance to offer customers worldwide reach and a smooth travel experience. Star Alliance received the Air Transport World Market Leadership Award in 2008 and was voted Best Airline Alliance by Business Traveller Magazine in 2003, 2006 and 2007 and by Skytrax in 2003, 2005 and 2007. The members are Air Canada, Air China, Air New Zealand, ANA, Asiana Airlines, Austrian, bmi, Egyptair, LOT Polish Airlines, Lufthansa, Scandinavian Airlines, Shanghai Airlines, Singapore Airlines, South African Airways, Spanair, SWISS, TAP Portugal, Turkish Airlines, THAI, United and US Airways. Regional member carriers Adria Airways (Slovenia), Blue1 (Finland) and Croatia Airlines enhance the global network. Air India and Continental have been announced as future members. Overall, the Star Alliance network offers 18,100 daily flights to 975 destinations in 162 countries. (www.staralliance.com)

| | |
|---|---|
| Total revenue: US$ 141.711 bn | Revenue Passenger Km: 990.24 bn |
| Daily departures: 16,500 | Annual Passengers: 499.90 m |
| Countries served: 159 | Number of employees: 393,559 |
| Airports served: 912 | Fleet: 3,325 |
| Lounges: 805 | |

**SkyTeam Alliance:** SkyTeam is the second largest airline alliance in the world behind Star Alliance partnering fourteen carriers from four continents, with two pending members. SkyTeam also operates a cargo alliance called SkyTeam Cargo with all SkyTeam members except for Continental Cargo.
When the merger of Northwest Airlines with Delta Air Lines is complete, SkyTeam will consist of 10 member airlines. Once Continental Airlines leaves SkyTeam for Star Alliance on October 24, 2009 (joining Star Alliance on the next day), it will only consist nine member airlines, which would make it the third-largest airline alliance in the world behind Star Alliance and Oneworld (smallest in terms of the big three

airline alliances) in terms of number of member airlines (but may not be necessarily the third-largest airline alliance and the smallest of the big three in the world in terms of number of passengers served. SkyTeam members are Aeroflot , Aeromexico, Air France, Alitalia, Chin,A Southern Airlines, Continental Airlines, Csa, Czech Airlines Delta Air Lines .KLM Royal Dutch Airlines Korean Air Northwest Airlines Air Europa Copa Airlines Kenya Airways. (www.skyteam.com)

| | |
|---|---|
| Destinations: 905 | Countries: 169 |
| Daily Departures: 16,787 | Annual Passengers: 462 million |
| Frequent Flyer Members: 152 million | Number of Lounges: 447 |
| Fleet: 2,496 mainline fleet (+1,255 from related carriers) | Employees: 356,998 |

**Oneworld Alliances** is the third largest airline alliance after Star Alliance and SkyTeam. Alliance member airlines and affiliates co-operate to provide an integrated service, usually around the use of common passenger terminals and standardisation of frequent flier schemes. Oneworld was established in 1999. The alliance management company is based in Vancouver, British Columbia, Canada. Oneworld was voted the world's best airline alliance in the 2004 Business Traveller Awards and named the World's Leading Airline Alliance for the sixth consecutive year at the 2008 World Travel Awards. Onewold members are American Airlines, British Airways, Cathay Pacific, Finnair, Iberia, Japan Airlines, LAN, Malév Hungarian Airlines, Qantas and Royal Jordanian, and around 20 affiliates including American Eagle, Dragonair, LAN Argentina, LAN Ecuador and LAN Peru. Mexicana and its affiliate Click Mexicana will join the alliance in later 2009. (www.oneworld.com)

| | |
|---|---|
| Destinations: 700 | Countries: 150 |
| Daily Departures: 8500 | Annual Passengers: 330 million |
| Number of Lounges: 550 | Fleet: 2,300 |
| Employees: 300.000 | |

The current members in these global networks and each alliance group's market share of the total worldwide scheduled service are listed in Table 1. *(*en.wikipedia.org/wiki/Airline_alliance)

**Table1. Membership and market date for the largest airline alliances as of December 2008**

| | **Star Alliance** | **SkyTeam** | **Oneworld** |
|---|---|---|---|
| **Passengers per year** | 499.90 million | 462 million | 328.63 million |
| **Destinations** | 912 | 905 | 673 |
| **Revenue (Billion US$)** | 141.71 | 97.9 | 99.78 |
| **Market share** | 29.3% | 20.6% | 23.2% |
| **Participants[1]** | (JP) Adria Airways<br>(AC) Air Canada<br>(CA) Air China<br>(NZ) Air New Zealand<br>(NH) ANA<br>(OZ) Asiana Airlines<br>(OS) Austrian Airlines<br>(KF) Blue1<br>(BD) BMI<br>(OU) Croatia Airlines<br>(MS) EgyptAir<br>(LO) LOT Polish Airlines<br>(LH) Lufthansa<br>(SK) SAS<br>(FM) Shanghai Airlines<br>(SQ) Singapore Airlines<br>(SA) South African Airways<br>(JK) Spanair<br>(LX) Swiss International Air Lines<br>(TP) TAP Portugal | (SU) Aeroflot<br>(AM) Aeroméxico<br>(UX) Air Europa<br>(AF) Air France<br>(AZ) Alitalia<br>(CZ) China Southern<br>(CO) Continental<br>(CM) Copa Airlines<br>(OK) Czech Airlines<br>(DL) Delta - Northwest (Merged)<br>(KQ) Kenya Airways<br>(KL) KLM<br>(KE) Korean Air | (AA) American Airlines<br>(BA) British Airways<br>(CX) Cathay Pacific<br>(AY) Finnair<br>(IB) Iberia<br>(JL) Japan Airlines<br>(LA) LAN<br>(MA) Malév<br>(QF) Qantas<br>(RJ) Royal Jordanian |

| | | | |
|---|---|---|---|
| | (TG) Thai Airways International<br>(TK) Turkish Airlines<br>(UA) United Airlines<br>(US) US Airways | | |

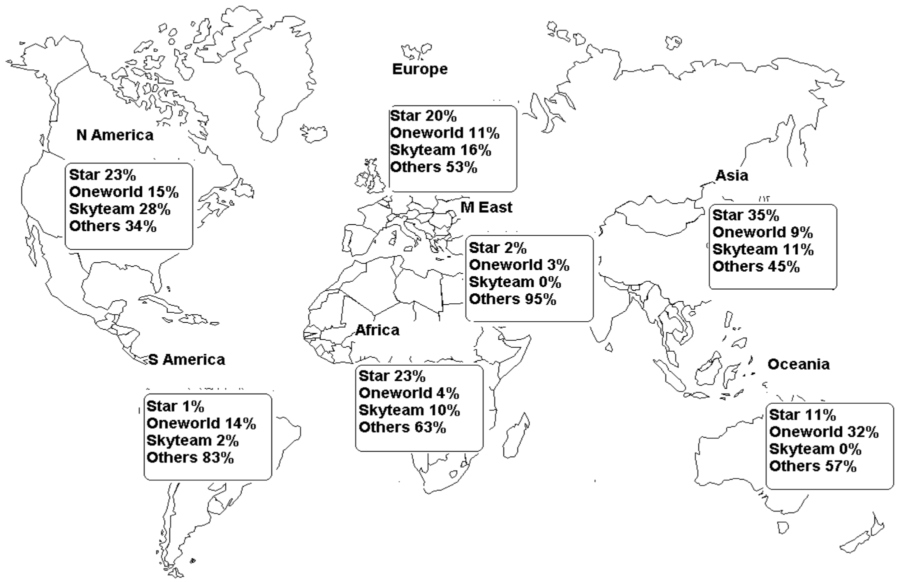



**Figure 1. Airline Alliance Market Share by Network Capacity 2007**
Source: Puffer, 2007

## Turkish Airlines

Turkey's national flag carrier was founded in Ankara on May 20, 1933, under the name of "State Airlines Administration" and started its operations depending on Ministery of Defence. In 1955, restructed into "Turkish Airlines" 25% of the company was sold via an SPO under the privatisation program in 2005. Today, 50, 9 % of the company shares are available for the public and the rest of the shares are state-owned. In 2007 Turkish Airlines became one of the fastest growing airlines among the European carriers in terms of growth in capacity and traffic, as well as being number one in least amount of lost luggage for the period. Turkish Airlines has been ranked as a 4 star Airline by the SKYTRAX magazine. With the fleet size of 102 aircraft, THY carried 19.65 million passengers in 2007 operated 108 international and 32 domestic, in total 140 direct flight destinations (142 airports). Turkish Airlines is one of the fastly growing airlines within the European market with a capacity of 20 million passengers in 2007. (www.staralliance.com)

Total revenue: US$ 2.7 bn
Daily departures: 460
Countries served: 69
Airports served: 142
Major hub airports: Istanbul, Ankara

Revenue Passenger Km: 30.29 bn
Annual Passengers: 19.65 m
Number of employees: 10,453
Fleet: 102

## What Are the Benefits THY?

The main benefits to THY; greater network access; seamless travel, transferable priority status, extended lounge access; enhanced frequent-flyer program (FFP) benefits. (Adapted from Goh, Uncles 2003)

**Greater network Access**: Wider route networks should attract passengers because of the preference of travelers for extensive networks (Driver, 1999). Kandampully and Duddy (1999) suggest that consumer loyalty and consumer retention can be enhanced by offering product and service packages assembled through networks of relationships, which collectively add value to the offer. Thus, an airline should be able to offer greater value to customers by extending its network of relationships with other airlines. At the very least, an alliance airline can offer more itinerary choices to its passengers than non-alliance airlines of similar size (Sultan and Simpson, 2000).

**Seamless travel**: A much-touted benefit is the concept of seamless travel (Rhoades and Lush, 1997). The current belief in the airline industry is that passengers want seamless travel when transferring from one airline to another (Bissessur and Alamdari, 1998). This is commonly achieved with codesharing, where an airline attaches its designator code to a service operated by another airline (Burton and Hanlon, 1994). Codesharing has been positioned as a consumer-oriented initiative (Sultan and Simpson, 2000). Star Alliance, which permits member carriers to share profits and revenues through a formula-based system, offers extensive codeshare flight options for its consumers, promising quick transfers and convenient check-in procedures. (Gallacher, 1999a) Moreover, as transfers incur the risk of missing connections and the loss of baggage (Veldhuis, 1997), having coordinated flights in global alliances can reduce consumer perceived risk and increase service levels. In addition to the convenience of seamless transfers, if the passenger decides to change flight plans at the last moment, he has the option of transferring to a variety of routes, airlines and schedules of the alliance network. Hence, there is flexibility for last minute changes to flight plans. This could be an important benefit to customers, especially those flying on non-direct long-haul flights.

**Transferable priority status**: Airlines have often accorded preferential treatment in the form of priority check-in, baggage handling, and reservation waitlist and airport standby, in their push to retain their most valued consumers. For the consumer, priority status achieved with one alliance member is now extended to all the partner airlines, offering greater access to priority benefits from a variety of airlines.

**Extended lounge access**: Global alliances also emphasize reciprocal access to alliance partner lounges as another benefit for the executive traveler with priority status. Prior to the formation of global alliances, the priority consumer could only use the lounge facilities of the airline with which he was flying.

**Enhanced FFP benefits**: In the past, FFP benefits accrued under one program were not transferable. With the formation of global alliances, frequent- flyer points and other benefits can now be accrued with any airline within an alliance, eliminating the need for membership of multiple frequent-flyer programs—unless the frequent flier particularly wishes to join more than one alliance. This means that FFP members can achieve priority status faster by accruing points under one program. In addition, with the expanded network offered by an alliance, redemption of points for awards can be made with any alliance partner for a greater variety of destinations (Hanlon, 1996). Moreover, as FFPs become increasingly ubiquitous and indistinct (Driver, 1999), the opportunity to earn and redeem benefits through global alliances is seen as another attempt to differentiate the numerous FFPs (Gallacher, 1999b).

Turkish Airlines is now offering the wide-ranging customer benefits of Star Alliance. These include among others; (www.nationmultimedia.com)

- Through check-in on journeys involving more than one Star Alliance member carrier from the originating airport

- Full frequent flyer reciprocity: All Turkish Airlines Miles & Smiles members can now collect and redeem miles on all other Star Alliance member carriers

- Star Alliance Gold status for Miles & Smiles Elite and Elite Plus: These customers can now access alliance-wide benefits which include access to more than 790 lounges world-wide, extra-baggage allowance, priority baggage delivery, dedicated check-in counters and priority waitlist (reservation) and airport stand-by

- Star Alliance Silver Status for Miles & Smiles Classic Plus: These customers are now entitled to priority waitlist (reservation) and airport stand-by

- Turkish Airlines will sell the 11 different Star Alliance Fare Products, which include among others the popular Round the World Fare, and North American and European Airpasses

- Turkish Airlines will also participate in Star Alliance's Corporate Plus and Conventions Plus products.

Specifically, star alliances offer at least four main benefits to THY

- Market access to overcome restrictions over route access and airline ownership imposed by national governments;
- Cost reductions and economies of scale, scope and density;
- Coordinated schedules and prices to optimize the demand for, and capacity of, each flight;
- Opportunities to reshape industry structure and to raise barriers against new entrants.

**Some comments**

"With Turkish Airlines we have gained a new member carrier with a strong home market which is also one of the fastest growing economies in the world. Moreover, we can now offer the Star Alliance benefits to a large number of new travellers, while at the same time simplifying travel for our existing customers to many of the new emerging markets in Central Asia and the Middle East," said Jaan Albrecht, Star Alliance CEO. (http://www.staralliance.com/ko/press/press_releases/2008/Tk_Joining_final.html)

Dr. Temel Kotil, the CEO of Turkish Airlines commented "Today Turkish Airlines will become Star's 21st member, and its logo will appear together with the Star Alliance logo at 841 airports. Membership in Star Alliance is going to give passengers on our airline, which currently flies to the European, American, Asian and African continents with the 101 aircraft in its fleet, access to more than 17,500 flights daily to 927 cities in 162 countries. Our passengers will also benefit from frequent flyer programs, have access to passenger lounges around the world, and be eligible for the alliance's special fare programs. Turkish Airlines' affiliation with Star Alliance is going to be a big boon for Istanbul as well, the home base of Turkish Airlines. The gateway between Europe and Asia for centuries, Istanbul is now poised to become the 'Bosphorus Bridge' of global aviation. Istanbul will become Star Alliance's main hub at the crossroads of Europe and Asia, contributing not only to Turkish Airlines but to the promotion of Turkey around the world. As the rising star of the world aviation sector, our goal is to become a global trademark." (www.nationmultimedia.com)

# CONCLUSION

Strategic alliances are increasingly perceived as strategic weapons even for competing within a firm's core business. (Harrigan, 1987) One of the most important developments in the global arena is the emergence of international airline alliances (Hanlon, 1999). Clearly, the biggest motivation for airlines to enter into alliances is to expand market feed. Some airlines that are dominant in their home markets have entered into an alliance with an international airline to provide feed to their airlines.

After joining Star Alliances THY have some benefits like a greater network access, seamless travel, transferable priority status; extended lounge access; and enhanced frequent-flyer program (FFP) benefits.Joining Star Alliance is a most important step for Turkish Airlines in becoming a major player and global airline in the world of aviation.

# REFERENCES


Achrol, R.S., Kotler, P., (1999), Marketing in the network economy. *Journal of Marketing*, 63, 146–163.

Bennett M. (1997), Strategic alliances in the world airline industry, *Progress in tourism and hospitality research*, 3, 213–223.

Bissessur, A., Alamdari, F. (1998), Factors affecting the operational success of strategic airline alliances. *Transportation*, 25, 4, 331–355.

Berechmank, J., Wit J. (1999), *On the future role of alliance, In: Taking Stock of Air Liberalisation,* Kluwer Academic Publishers.

Bretherton P. (2003), The Rationale for Strategic Alliances: An Empirical Study, *Journal of Euromarketing*, Vol. 13, 1, 73.

Burton, J., Hanlon, P., (1994), Airline alliances: co-operating to compete?, *Journal of Air Transport Management*, 1, 4, 209-277.

Burdett, J. O. (1991), A model for customer-supplier alliances, *Management Decision*, 29, 5, 28-34.

Chang Y., Hsu C. (2005), *Ally or Merge-Airline Strategies after the Relaxation of Ownership Rules,* Proceedings of the Eastern Asia Society for Transportation Studies, 5, 545 -556.

Day, G.S., (1995), Advantageous alliances. *Journal of the Academy of Marketing Science,* 23, 4, 297–300.
Doganis, R. (1994), The Impact of liberalization on European airline strategies and operations, *Journal of Air Transport Management*, 1, 1, 15-25.

Doganis, R. (2001), The airline business in the 21st century. Routledge, London.

Doz, Y. L., Hamel, G. (1998), *Alliance Advantage: The Art of Creating Value through Partnering*, Harvard Business School Press, MA.

Driver, J.C., (1999), Developments in airline marketing practice, *Journal of Marketing Practice: Applied Marketing Science,* 5, 5, 134-150.

Gallacher, J., (1999a), Circling the globe. *Airline Business*, (July), 34-37.

Gallacher, J. (1999b), Playing your cards right. *Airline Business* (August), 46-50.

Goel A., Strategic Alliances in the Global Airline Industry,
http://www.iimahd.ernet.in/publications/data/2003-01-02AbhishekGoel.pdf , (08.04.2009)

Goh K., Uncles M., (2003), The benefits of airline global alliances: an empirical assessment of the perceptions of business travelers, *Transportation Research Part A*, 37, 479–497,

Hamel, G., Doz, Y. L., Prahalad, C. K., (1989), Collaborate with your competitors - and win, *Harvard Business Review,* January/February, 133–139.

Hamel, G., Doz, Y.L., (1998), *Alliance Advantage–The art of creating value through partnering*, Harvard Business School Press, Boston, MA.

Hanlon, P. (1996), *Global Airlines: Competition in a Transnational Industry.* Oxford: Butterworth-Heinemann

Harrigan, K. R. (1992), Strategic alliances: their new role in global competition, *Columbia Journal of World Business,* summer, 67–69.

Iatrou K. Alamdari F. (2005), The empirical analysis of the impact of alliances on airline operations, *Journal of Air Transport Management,* 11, 3, 127-134.
International Air Transport Association. (2001), *Recommended Practice 1008*, 21st ed. International Air Transport Association.

Morrison, S.A. Winston C. (1995), *The Evolution of the Airline Industry*, Brookings Institution, Washington, DC.

Oum, T. H., Park, Jong-Hun, Zhang, A. (2000), *Globalization and Strategic Alliances: The Case of the Airline* Industry, Pergamon: Oxford, UK.

Oum, T. H., Taylor, A. J., Zhang, (1993), A. Strategic Airline Policy in the Globalizing Airline Networks; *Transportation Journal*, Spring, 32, 3, 14-29.

Oum, T.H., Park, J.H., (1997), Airline alliances: current status, policy issues and future directions, *Journal of Air Transport Management*, 3, 3, 133-144.

Ohmae, K. (1989), The global logic of strategic alliances, *Harvard Business Review,* March/April, 143-154.

Puffer M., (2007), Network Facts & Figures.
http://www.staralliance.com/int/press/media_library/presentations/star_alliance_network_facts_and_Figures_Dec_2007.pdf , (08.05.2009).

Rhoades, D.L., Lush, H., (1997), A typology of strategic alliances in the airline industry: propositions for stability and duration, *Journal of Air Transport Management* 3, 3, 109–114.

Kandampully, J., Duddy, R., (1999). Relationship marketing: a concept beyond the primary relationship. Marketing, *Intelligence and Planning*, 17, 7, 315-323.
Semercioz, F. Kocer, B., (2004), Strategic Alliances in the Aviation Industry: An Analysis of Turkish Airlines Experience, *Journal of Transnational Management Development*, 9, 2, 29-45.

Sultan, F., Simpson, M.C., (2000), International service variants: airline passenger expectations and perceptions of service quality, *Journal of Services Marketing,* 14, 3, 188-216.

Ruwantissa I. R. Abeyratne, (2000), Strategic alliances of airlines and their consequences, *Canada Journal of Air Transportation Worldwide,* 5, 2, 55-71.

Stickler, J., (2001), Building successful strategic alliances, *Strategic Direction*, 17, 8, 3-4.

Thayer, J. D. (1994), The tender trap, *Journal of European Business,* 5, 3, 34–38

Veldhuis, J. (1997), The competitive position of airline networks, *Journal of Air Transport Management*, 3 (4), 181–188.

Weber, M., Dinwoodie, J., (2000), Fifth freedom and airline alliances, The role of fifth freedom traffic in an understanding of airline alliances. *Journal of Air Transport Management,* 6, 51–60.

Williams, G. (1993), *The Airline Industry and the Impact of Deregulation.* Aldershot, Ashgate Publishing

Wit, J. G., (1995), An urge to merge?, *Journal of Air Transport Management*, 2, (3/4), 173-180.

Airline Alliance, en.wikipedia.org/wiki/Airline_alliance, (06.05.2009)

http://en.en.wikipedia.org/wiki/SkyTeam

OneworldTeam, http://en.wikipedia.org/wiki/Oneworld (08.05.2009)

News and Information, http://www.oneworld.com/ow/news/details?objectID=17291(06.05.2009)

Star Alliances, Facts & Figures,
www.staralliance.com/int/press/facts_figures/star_alliance_facts_and_figures_dec2008_final.pdf, (06.04.2009)

SkyTeam Facts & Figures,
http://skyteam.com/downloads/news/facts/skyteamFactSheet.pdf , (06.04.2009)

"Turkish Airlines joins Star Alliance",
http://www.nationmultimedia.com/search/read.php?newsid=30070444&keyword=travel , (11.04.2009)

"Turkish airlines joins star alliance",
http://www.staralliance.com/ko/press/press_releases/2008/Tk_Joining_final.html April 1st, 2008, (03.04.2009)

# ATTITUDES TOWARDS STRATEGIC SUPPLIER ALLIANCES IN THE NATURAL STONE SUPPLY CHAIN: THE CASE OF GLOBAL COMPANIES

**Süleyman BARUTÇU,**
**Pamukkale University, Turkey**
**Mustafa TANYERİ,**
**Dokuz Eylül University, Turkey**
**Şükrü GÖREN,**
**BuildDirect, Canada**

## ABSTRACT

*The main objectives of this paper are to (1) analyze the importance and role of strategic supplier alliances for enhancing the performance of a supply chain, (2) to reveal managers' attitudes and behaviors towards strategic supplier alliances in the natural stone industry from distributors' perspectives and (3) to bring out the conditions and possibilities of establishing strategic supplier alliances in the natural stone industry, and (4) to assess the long-term prospects for the strategic supplier alliances in the natural stone industry by examining how the managers are perceived strategic supplier alliances. According to the 48 questionnaire-results, respondents have positive attitudes towards strategic supplier alliances, and find it as a functional strategy in the natural stone industry. However, some of them (21 respondents) do not prefer to form strategic supplier alliances because they do not want to lose their operational control and independence. On the other hand, some of them (27 respondents) are eager to form strategic supplier alliances with Italian, Turkish, Indian and Chinese companies that have unique or rare natural stones quarries. The research results will be supportive for natural stone quarries and exporters planning to form strategic supplier alliances.*

***Keywords***: *Strategic Alliances, Supply Chain Management, Strategic Supplier Alliances, Natural Stone Industry*

## INTRODUCTION

In the highly competitive business environments, lower cost, higher quality, better information flows and less uncertainty etc. are very important for profitable companies, and suppliers have a large and direct impact on the quality and cost of products and services. Moreover, the trend to outsource more materials and services make companies more reliant on their sources of supply. This leads to a move towards increasingly collaborative supplier relationships and supply chain management systems (Stuart and McCutcheon, 2000). In order to emphasize core competencies and skills, companies assume narrow and specialized roles within supply chains while companies ally themselves with supply-chain partners and strategic supplier alliances for mutual benefits (Myhr and Spekman 2005). Many of today's companies are relearning how to compete more effectively, not only in domestic markets, but also in global markets. To accomplish this adaptation many of these companies are altering the strategies employed. They are now de-emphasizing autonomy in favor of alliances through cooperation, coordination, and corroboration of their competitive efforts (Pett and Dibrell, 2001).

Traditionally, the American, Japanese and European companies have used strategic alliances to gain competitive advantages in world markets. Many companies all over the world have started to understand the importance of employing strategic alliance to deal with foreign competition and to enter foreign markets. The emergence of truly global markets will only add to the number of companies who see strategic alliances as a means to compete in an ever more competitive world markets (Vyas et al., 1995). Moreover, in recent years strategic supplier alliances have become increasingly important to both buyers and suppliers striving to respond to heightened competitive pressures. They reflect recognition by alliance partners that a cooperative relationship may facilitate achieving mutual competitive advantage (Kannan and Tan, 2004). Nowadays, because of the global economic crisis and recession, the natural stone exporters need to turn suppliers and customers into partners willing to cooperate enthusiastically in supplying, marketing and distributing the natural stones. Therefore, in this study, the concepts of supplier alliances, supply chain management and strategic supplier alliances are explained, and the long-term prospects for the strategic supplier alliances in the natural stone industry are assessed.

# CONCEPTUAL FRAMEWORK

The competitiveness in global economy forces companies to develop and use new strategies that can quickly respond to customer needs. Strategic alliances, supply chain management and strategic supplier alliances are some of the important strategies in order to get competitive advantages.

## Strategic Alliances

Though strategic alliances are not a new concept, they have become one of the most important managerial forms in modern society and are well-known tools available to multinational business managers (Mockler, 2001). A few years ago strategic alliances were perceived as an option reserved only for corporate giants. Today, however, for many companies, a go-it-alone strategy no longer seems to be a viable alternative. Intensified foreign competition, shortened product life cycles, soaring cost of capital, including the cost of research and development, and ever-growing demand for new technologies, alliances are becoming an attractive strategy for the future (Vyas et al., 1995). Historically, strategic alliances are an age-old practice designed to unite two or more entities for a common purpose, and royal families dating back centuries employed alliances to protect and enlarge their domains. In common business usage, an alliance is one of a group of strategic approaches in the "cooperative strategies" group. The benefits of an alliance, in theory, are relatively straightforward. Two or more entities combine their core competencies in order to provide a product or service that is superior to that which any of the parties could singularly provide. Ideally, the alliance partners will mutually benefit from the relationship by learning new skills and capabilities or gaining exposure to new markets. In the strategic alliances, the targeted outcome is a product or service that the alliance partners individually would otherwise be unable to offer customers (Dalton, 2009). Thus, the strategic alliances provide benefits to companies that cannot obtain alone, and these equations (1+1=3 or 2+2=5) are realized.

Strategic alliances can be as simple as the case in which two companies sharing their technological and/or marketing resources. In contrast, they can be highly complex, such as involving several companies, located in different countries. Thus, the strategic alliances can be defined as (1) a long-term, explicit contractual agreement pertaining to an exchange and/or combination of some of a company's resources with one or more other company (Burgers et al., 1993), (2) an agreement between two or more partners to share knowledge or resources which could be beneficial to all parties involved (Vyas et al. 1995), or (3) a long-term cooperative arrangement between two or more independent companies that engages in business activities for mutual economic gains (Tsang, 1998). As the difficulty of definition indicates, the structure of strategic alliances identified in the literature runs the full gamut from R&D collaboration to licensing to joint ventures to complete mergers. Therefore, the most remarkable types of strategic alliances include joint ventures, licensing, franchising, equity ownership and marketing, distribution or logistics-based alliances. These types represent different managerial formations that seek to achieve business objectives through collaboration better than through competition (Knoke, 2005).

There were many strategic alliances in the world. Briefly, there were 37,538 strategic alliances in the USA, 9,417 strategic alliances in Japan and just 212 strategic alliances in Turkey between 1990 and 1999 among 30 OECD countries (Tekinay, 2004). Although, IBM alone had engaged in over 400 strategic alliances by 1995, some of the well-known successful examples in different industries were between Mercedes and Chrysler, GM and Toyota, Canon and Kodak, Siemens and Philips etc. Most of them were actually among global companies like Ford and Volkswagen for sharing a distribution and service center in South America and Ford and Nissan for building minivans in the USA (Griffin, 1999). Strategic alliances can be used by small and medium-sized companies to build on innovative capability and technological competence, and overcome weaknesses such as a poor financial position or low levels of expertise in production, marketing and management (Jarratt, 1998).

There are several reasons to form the strategic alliances. The trend toward strategic alliance is clear; it is not a passing fad (Jarratt, 1998). The international business literature has already acknowledged a number of positive outcomes for companies actively engaged in strategic alliances, such as higher return on equity, better return on investment, and higher success rates (Knoke, 2005). Moreover, strategic alliances can assist organizations to acquire the means to compete within an ever complex and changing environment (Jarratt, 1998), and may be formed to enter new business, obtain new skills, share risks and resources, gain quick access to new markets, overcome trade barriers, absorb a key local competitor and avoid predatory competition (Inkpen et al., 1997; Hitt et al., 1995). Moreover, building stronger domestic and international business is a commercial necessity, and the emergence of regional trading blocs, the ease of technology transfer, and the internationalization of markets have prompted companies to look at each other in a different light – as allies rather than adversaries (Vyas et al. 1995). Furthermore, strategic alliances are formed as a mechanism for reducing uncertainty for parties of the alliances (Burgers et al., 1993). Many strategic alliances have created the greatest degree of mutual value, and thereby sustain a competitive advantage in the marketplace, and been most successful when the originating motives are positive, and the desire is to create new value, rather than an attempt to hide weaknesses, or merely exchange value, and the relationship provides a stream of follow-up opportunities (Day, 1995).

## Supply Chain Management

Faced with the increasing pressure to improve responsiveness to the changing market needs rapidly, companies must respond to the challenge of how to improve supply reliability and quality, while simultaneously reducing costs (Kannan and Tan, 2004). As suppliers play very important role in the competitiveness of the companies, Chrysler and Ford changed their supplier management principles, contributed to dramatic improvement in financial performance of the company. They reduced its total number of suppliers, worked limited suppliers, and developed strategic supplier alliances in which the suppliers were asked to play an active role in product development and process improvement. After this, the total amount of work their suppliers performed effectively increased and the performance, innovation, competitiveness, and long-term survival of the members of the supply chain also improved (Lorincz, 1985; Dyer, 1996; Famuyiwa et al., 2008). Therefore, the supply chain management has been considered as the most popular operations strategy for improving organizational competitiveness in the twenty-first century, because this system incorporates the entire exchange of information and movement of products between suppliers and final customers, including manufacturers, distributors, retailers, and any other companies within the extended supply chain (Gunasekaran et al., 2008). The Global Supply Chain Forum defines Supply Chain Management as the integration of key business processes from end user through original supplier that provides materials, products, services, and information that adds value for customers and other stakeholders (Lambert et al., 1998).

A recent movement in supplier management has been the increased development of closer ties with selected supplier companies, with broadened expectations about what both buyer and supplier receive through their ongoing relationship. Nowadays, the different standards for supplier relationships have been variously termed as supplier development, supply chain partnership, supplier partnerships, co-operative supplier relationships, supplier alliances and strategic supplier alliances.

## Strategic Supplier Alliances

The trend to outsource more materials and services has made companies more reliant on their sources of supply. The raising supply quality and reliability have led to an increase in outsourcing and the adoption of supplier alliances with key suppliers, and led to a move towards increasingly collaborative supplier relationships, referred to as strategic supplier alliances (Stuart and McCutcheon, 1996; Kannan and Tan, 2004). The strategic supplier alliance is a relationship formed among companies in the supply chain to achieve specific objectives and benefits. A fundamental purpose of strategic supplier alliances is to enhance the long-term competitiveness of strategic partners in the supply chain. In order for strategic supplier alliances to be viewed as strategic, they must enable the cooperating companies to achieve some type of competitive advantage in the supply chain. This specific alliance is usually formed to increase operational performance of each member through reductions total production, inventory, and quality control costs, and increased shared information and profits. Theoretically within a strategic supplier alliance, traditional competitive barriers between supply chain members are mitigated to create mutually beneficial relationship, thus leading to increased information flows, reduced uncertainty, and a more profitable supply chain. Rather than concerning themselves only with price, manufactures are looking to suppliers to work cooperatively in providing improved service, innovations and product design (Maloni and Benton, 1997).

Specifically, a strategic supplier alliance is a relationship marked by mechanisms for buyer-supplier collaboration to solve problems and to share the benefits that are derived from quality or productivity gains that the joint efforts provide. Such alliances are intended to provide competitive advantage to the buyer through greater flexibility, more technical input from the supplier, quicker response and reduced total purchasing costs; the supplier gains through better planning information, greater demand security and, often, technical assistance from the buyer (Stuart and McCutcheon, 1996). Furthermore, the strategic supplier alliances emphasize a direct, long-term association, encouraging mutual planning, problem solving, improvement and success sharing. Mutual problem solving can result in a win-win solution among partners, because this can help to improve quality, performance, reduce cost etc. after establishing strategic supplier alliances. Supply quality can be improved through forming strategic supplier alliances with key and few important suppliers (Maloni and Benton, 1997). For example, Kannan and Tan (2004) presented the results of a survey of supply management professionals that examines attitudes of adopters and non-adopters of supplier alliances to supplier and quality management, and indicated that significant differences in attitudes exist between alliance adopters and non-adopters. Alliance adopters attach greater importance than non-adopters to ensuring that suppliers have taken steps to ensure high levels of product quality. However, Stuart and McCutcheon (1996) found that as the alliance matured, the purchasing companies perceived some improvements in benefits from strategic supplier alliances, even though benefits changed significantly.

## Natural Stone Industry and Global Natural Stone Supply Chain

Traditionally, the natural stone is luxury architectural material, and natural stone industry is one of the oldest industries in the world. Companies running business in this industry are facing and will continue to face competition from numerous forces because natural stones and building materials are more popular than ever. Marble, Travertine, Granite and Onyx etc. are some of the natural stone's name. Main uses of natural stones are flooring, exterior and interior cladding, stairs, funeral arts in Turkey and in the world. Moreover, flooring in prestigious admin buildings, schools, airports, hospitals, banks, etc. is laid with elegant looking natural stones like Marble, Travertine or Granite. Therefore, natural stone industry is one of the potential profitable industries in the world. From demand perspectives, the developed countries like the United States of America (USA), Canada, England, Germany and some Arabic countries like the United Arab Emirates, Saudi Arabia etc. are very important buyers and users of natural stones. From supply perspectives, international competition is observed among limited countries like Italy, Spain, Turkey, Iran, India, Brazil, Mexico, Peru, Egypt and China which have had important progress in the global natural stone industry.

From global supply chain perspectives, the companies participated in a natural stone supply chain are inextricably connected together all through the entire sequence of events that extract of blocks from quarries through to the ultimate customer as processed natural stones. The natural stones go through several stages before reaching the end customers. There are many processes, suppliers and customers in the natural stone supply chain. Extraction of natural stone blocks from quarries, transportation to processing plants and block cutting are the main three stages. After cutting rough blocks, the processes of splitting, first honning, filling, second honning, polishing, sizing, packaging, stocking and loading activities are implemented. Moreover, architects are added in natural stone supply chain because of their influences to in the special construction projects. The most important stage is to take orders and distribute the processed natural stones to final customers (Barutçu, 2008).

Presently, Europe and the USA head into an inevitable economic recession during the last quarter of 2008 because global economic crisis began in 2007 with the unpaid mortgage credits. The root cause of this crisis is the real estate market, and it was blamed on bankers' excessive leveraging of assets. As with the current crisis, both of these involved real estate bubbles that ultimately burst. Losses from real estate ultimately deplete a bank's capital by depleting stockholders' equity (Udell, 2009). Although the financial industry in the US is one of the main reasons for global economic crisis, the economic recession could have shocking effects in any industry unrelated to the financial industry (Quelch, 2008). For this reason, the global economic recession hits many industries from automotive to construction industries. Nowadays, it has started to hit and force buyers, distributors and wholesalers to reduce their natural stone orders. As the USA construction industry has fallen, it has created a huge inventory overhang, both in new houses and existing homes sales. This has created an inventory overhang for products that has had enormous implications on businesses serving construction market. Many companies in the United States were caught with too much inventory and significantly declining demand that has forced and is forcing many to declare bankruptcy. As these companies fail, there is a domino effect around the world as many exporters, importers, agents, and manufacturers fail as well (Booth, 2008). Consequently, in natural stone industry, natural stone demands for them in world's largest markets of the USA and Europe has been decreasing, many distributors and wholesalers have been geared totally to marketing to sell their stock goods, and many quarries throughout the world have come to stop their operations because of the decline in export since the crisis began in 2008.

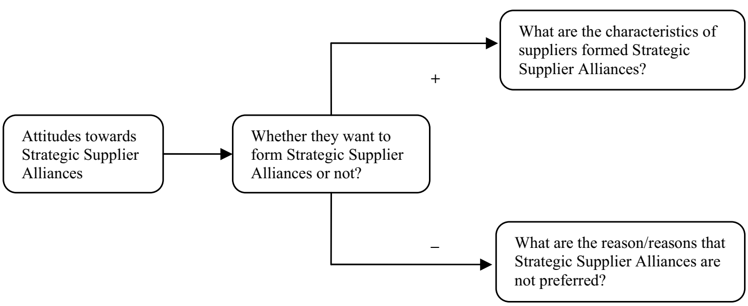
At this time, the Turkish natural stone industry has been the scene of many downsizing and out of business activates since 2008, and some natural stone companies seek to enhance market share and develop their bottom lines with business synergies. As explained before, collaboration among supply chain members is necessary to improve their competitiveness in this natural stone supply chain. If they establish strategic supplier alliances in their supply chain, they will get very important competitive advantage in the highly competitive natural stone industry.

# ATTITUDES TOWARDS STRATEGIC SUPPLIER ALLIANCES IN THE GLOBAL NATURAL STONE SUPPLY CHAIN

Under the highly competitive natural stone industry, Turkish companies are searching for new ways to improve their competitive positions in natural stone markets. Forming the strategic alliance among rivals or strategic supplier alliances among suppliers in a supply chain is one of the major ongoing interests in the strategic management literatures. Therefore, the natural stone exporters need to turn suppliers and customers into partners willing to cooperate enthusiastically in supplying, marketing and distributing the natural stones, because the emerging area of supply chain alliances or strategic supplier alliances have received considerable attention in the academic and managerial literatures (Monczka et al., 1998). For example, the Chamber's President of Industry and Commerce of Afyonkarahisar-Turkey declared that "Italy should have been our partners not rivals in the natural stone industry because not only Turkish but also Italian natural stone companies could not generate enough revenues and profits" (Gürel, 2008).

According to previous survey results from the manufactures perspectives in Turkish natural stone industry, the managers or owners of the companies (1) found strategic supplier alliances mutually beneficial for all partners in a supply chain, and (2) were eager to improve their relationship, cooperation and collaboration with their suppliers and customers, (3) preferred informal agreements to mergers or full partnerships, and (4) were more enthusiastic to establish production-based strategic supplier alliances with Italian and Spanish than Chinese companies and marketing-based strategic supplier alliances with many companies from all over the world (Barutçu, 2008). In this stage, conducting the new research to determine attitudes toward strategic supplier alliances from distributors' perspective is very important.

**Figure 1. Research Framework**




As seen in Figure 1, the main objective of the new research is to reveal managers' attitudes towards strategic supplier alliances in the global natural stone industry in the worldwide from the distributors' perspectives in order to determine their attitudes and expectations from strategic supplier alliances.

## Research Methodology

Both face-to-face and online survey methodologies are used to collect primary data. The online research was conducted worldwide -North America, Asia, Europe, Africa, Australia and the Middle East- among the natural stone distributors and/or wholesalers between March 25 and April 17, 2009 via e-mail from the managers of the global natural stone buyers and distributors in the several countries. The face to face research was conducted in MARBLE 2009 - 15th International Natural Stone and Technology Fair, between March 25 and 28, 2009 in Izmir, Turkey. The e-mail addresses of natural stone distributors and/or wholesalers were reached from the Internet (www.google.com and www.superpages.com/yellowpages/C-

Natural+Stone+Wholesale/. As a result, many questionnaires were sent to these e-mail addresses, and distributed in the fair. Finally, 48 questionnaires were responded and returned. The reliability of the questions used Likert scale was assessed by the Cronbach's Alpha reliability coefficient that is one of the tools for assessing the reliability of scales. Cronbach's alpha verifies the internal consistency or average correlation of items in a survey questions to gauge its reliability. Reliability value calculated 0,7583 for just 2 questions (26 items) for 27 questionnaires and exceeded the suggested value of 0,70.

The questionnaire were developed from the existing studies and self-created. In the questionnaire, there were 14 questions and 38 items in 4 sections. In the first section, there were 6 questions provided respondents' positions, profiles of the company (sizes and types) and countries that have operations and imported natural stones. In the second section, there are 2 questions and 8 items elicited attitudes towards strategic supplier alliances and whether respondents want to form strategic supplier alliances or not. In the third section, there were 5 questions and 18 items for partner selections. In the fourth section, there was 1 question elicited the reason/reasons that strategic supplier alliances are not preferred. SPSS 11.5 for Windows were used to analyze data. The frequencies of the answers used nominal scales, mean and standard deviations of questions used in Likert scale were calculated for exposing their attitudes towards strategic supplier alliances.

## Research Findings

In terms of the respondents' positions, among the 48 respondents, 29,8% were marketing managers, 20,8% were general managers, and 18,8% purchasing managers of the natural stone companies. In terms of the type/types of the company, 52,1% was wholesalers, 25% distributors, and 20,8% are importer of natural stones. In terms of company sizes, there are 21 natural stone companies employed less than 10 workers, 13 companies employed between 11 and 51 workers, therefore, most of the companies are the small and medium sized. In terms of the year of the company foundation, among 48 companies, 20 of them were founded between 1981 and 2000, 14 of them were founded between 1961 and 1980, and 11 of them were founded after 2001. Most of the companies' origins are from European (Italy, Germany, England and Austria), North American (the United States of America and Canada), Asia (China) and Middle East (United Arab Emirates, Bahrain and Kuwait) countries.

**Table 1: The Characteristics of Respondents and Natural Stone Companies**

| *Variable* | *N* | *%* | *Variable* | *N* | *%* |
|---|---|---|---|---|---|
| *Respondent's Position* | | | *The type/types of the company* | | |
| President/CEO | 7 | 14,6 | Distributor | 12 | 25,0 |
| General Manager | 10 | 20,8 | Wholesaler | 25 | 52,1 |
| Marketing Manager | 14 | 29,2 | Dealer | 8 | 16,7 |
| Purchasing Manager | 9 | 18,8 | Importer | 10 | 20,8 |
| Import/Export Manager | 6 | 12,5 | Retailer | 7 | 14,6 |
| Others | 2 | 4,2 | Others | | |
| *The number of worker* | | | *The year of* company *foundation* | | |
| Up to 10 | 21 | 43,8 | Before 1960 | 3 | 6,3 |
| 11-50 | 13 | 27,1 | 1961-1980 | 14 | 29,2 |
| 51-100 | 9 | 18,8 | 1981-2000 | 20 | 41,7 |
| More than 101 | 5 | 10,4 | After 2001 | 11 | 22,9 |
| *The country / countries imported natural stones* | | | *The origin country /countries of the company* | | |
| Italy | 25 | 52,1 | European Countries | 23 | 47,9 |
| Spain | 5 | 10,4 | Middle East Countries | 8 | 16,7 |
| Brazil | 12 | 25,0 | North American Countries | 18 | 37,5 |
| Turkey | 37 | 77,1 | Asian Countries | 7 | 14,6 |
| China | 13 | 27,1 | | | |
| Peru | 8 | 16,7 | | | |
| India | 14 | 29,2 | | | |
| Mexico | 16 | 33,3 | | | |

Most of the respondents import natural stones from Turkey (77,1%), Italy (52,1), Mexico (33,3%), China (27,1) and India (29,2%). In a word, most of the respondents are marketing managers, and most of the natural stone companies are small and medium sized, founded between 1981 and 2000, are wholesalers and distributors, have operations in Europe and North America, and imported natural stones from Turkey, Italy, and Mexico (Table 1.)

According to the eight attitude statements towards strategic supplier alliances in the natural stone industry, the respondents believe that "this industry is suitable for forming strategic supplier alliances" ($\overline{x} = 4{,}2083$) and "the strategic supplier alliance is one of the most important competitive tools in the highly competitive natural stone markets" ($\overline{x} = 3{,}9167$). The respondents are of the opinion that competitors' alliances will be in danger for them ($\overline{x} = 3{,}8333$), and this strategy is a requirement for their competitiveness in global natural stone industry ($\overline{x} = 3{,}7708$). Moreover, respondents consider that it is not early to establish strategic supplier alliances ($\overline{x} = 2{,}4792$), and not difficult to found long lasting strategic supplier alliances ($\overline{x} = 2{,}6042$). However, although respondents are willing to put more effort establishing strategic supplier alliances ($\overline{x} = 3{,}5833$), the possibility of forming strategic supplier alliances with their suppliers is not high ($\overline{x} = 3{,}1145$) (Table 2).

**Table 2. Descriptive statistics of attitude statements**

| The attitude statements towards strategic supplier alliances | *Mean* | *SD* |
|---|---|---|
| We are willing to put more effort establishing strategic supplier alliances. | 3,5833 | ,87113 |
| We are likely to establish strategic supplier alliances with our suppliers. | 3,1145 | ,49822 |
| Our industry is suitable for such strategic supplier alliances. | 4,2083 | ,74258 |
| The strategic supplier alliance is one of the most important competitive tools in the highly competitive natural stone markets. | 3,9167 | 1,06857 |
| It seems too early to establish strategic supplier alliances in natural stone industry. | 2,4792 | ,89893 |
| I believe that strategic supplier alliances will be a prosperous strategy in global natural stone industry. | 3,7708 | ,97281 |
| It is difficult to establish long lasting strategic supplier alliances in natural stone industry. | 2,6042 | 1,33272 |
| If our competitors establish strategic supplier alliances, it will be threat of our businesses. | 3,8333 | ,83369 |

* Scale: A five-point Likert scale from 1.Strongly Disagree to 5. Strongly Agree

As seen in table 2, they have positive attitudes towards strategic supplier alliances, and find functional strategy in the natural stone industry. Nevertheless, respondents are asked whether to form strategic supplier alliances or not. Among 48 respondents, the 27 respondents (56,3%) want to establish strategic supplier alliances with their suppliers, 21 respondents (43,8%) do not prefer to form them. To maximize cooperation among the partners, the following criteria should be taken in consideration in partners' selection.

**Table 3. The importance of the factors considered partner selections**

| The factors considered for partner selection* | *Mean* | *SD* |
|---|---|---|
| Trust between top management teams | 4,5714 | ,50395 |
| Partner's willingness to integrate natural stone supply chain | 4,3929 | ,49735 |
| Partner's production knowledge | 4,3214 | ,47559 |
| Reputation of supplier | 4,2857 | ,53452 |
| Capabilities to provide quality | 4,2158 | ,46004 |
| Current relationship with supplier | 4,1429 | ,70523 |
| Product variety of supplier | 4,1357 | ,69293 |
| Partner's response time to questions and problems | 4,1225 | ,50395 |
| Ability to meet delivery due dates | 4,0287 | ,80343 |
| Supplier's market share | 3,9643 | 1,03574 |
| Supplier's ability to make a decent profit | 3,8571 | ,70523 |
| The number of partners' quarries | 3,2500 | 1,43049 |
| Partner's financial power | 3,2143 | 1,37051 |
| Proximity to the market | 3,1786 | 1,21879 |
| Degree of favorable past experience with partner | 3,0714 | 1,63137 |
| Partner's international experience | 2,9286 | 1,18411 |
| Cultural match between the companies | 2,8929 | 1,16553 |
| Partner's firm size | 2,5357 | 1,07090 |

* Scale: A five-point Likert scale from 1.Not Important to 5. Very Important

Effective strategic supplier alliance management begins with selecting the right suppliers. According to 27 respondents who want to form strategic supplier alliances, trust between top management teams, partner's willingness to integrate natural stone supply chain, partner's production knowledge and reputation, capabilities to provide quality are some of the most important factors. On the other hand, partner's international experience, cultural match between the companies, and partner's firm size are less important factors to establish strategic supplier alliances (Table 3). While there are many critical factors to the long-term success of strategic supplier alliances; trust, willingness, knowledge and supplier quality are some of the most essential factors to form strategic supplier alliances.

The company who wants to form strategic supplier alliances should have unique or rare natural stones quarries, and high supports of owners and managers. Beside, the managers of companies should be trusted and reliable. Moreover, allied companies should have the same long-term strategic goals, joint problem solving, and similar approach to customers and/or markets. Therefore, there should be good fit between suppliers and companies. The same long-term strategic goal is one of the most important characteristics that each partner has (Table 4).

**Table 4. The characteristic/characteristics wanted to form strategic supplier alliances**

| The characteristics of companies | *N* | *%* |
|---|---|---|
| Suppliers' unique or rare natural stones | 25 | 92,6 |
| The same long-term strategic goals | 21 | 77,8 |
| Open communication | 15 | 55,6 |
| Supports of owners and managers | 14 | 51,9 |
| Trusty and reliable managers | 23 | 85,2 |
| Joint problem solving | 12 | 44,4 |
| Similar approach to customer/market | 11 | 40,7 |

In terms of alliances' forms, 21 out of 27 respondents prefer long-term contractual arrangements, 17 respondents would rather increase relationship with partners, 14 respondents prefer creating new partnership in the natural stone industry. In contrast, non formal handshake or verbal agreements and merger are the least preferred alliances' forms (Table 5).

**Table 5. Preferred strategic supplier alliances form/forms**

| The forms of strategic supplier alliances | *N* | *%* |
|---|---|---|
| Increased relationship with partners | 17 | 63,0 |
| Long-term contractual arrangements | 21 | 77,8 |
| Non formal handshake or verbal agreements | 9 | 33,3 |
| Joint venture | 13 | 48,1 |
| Merger | 4 | 14,8 |
| Create new partnerships | 14 | 51,9 |

By the order of the most important expectations, the respondents obtain from successful strategic supplier alliances to share potential risk, improve their financial performance, work with more reliable suppliers, bring new opportunities, shorten delivery time, increase their competitiveness, maintain their competitive positions, add strategic value and increase integrity with their suppliers (Table 6).

**Table 6. The respondents' expectations from strategic supplier alliances**

| Expectations from strategic supplier alliances | *N* | *%* |
|---|---|---|
| Share the potential risk | 23 | 85,2 |
| Improve firm performance | 21 | 77,8 |
| Work more reliable suppliers | 20 | 74,1 |
| Bring new opportunities | 18 | 66,7 |
| Offer lower price | 17 | 63,0 |
| Short lead times | 15 | 55,6 |
| Increase competitiveness | 14 | 51,9 |
| Maintain competitive position in existing market | 14 | 51,9 |
| Add strategic value | 12 | 44,4 |
| Increase integrity | 11 | 40,7 |

Respondents ranked 8 countries with respect to one another to form their preference of strategic supplier alliances from the most-preferred to the least-preferred with an ordinal measurement scale. According to the answers of this question, Italian and Turkish natural companies are the first, Indian companies are second, and Chinese companies are third, and Peruvian companies are the last preferred to establish strategic supplier alliances in the global natural stone supply chain. Therefore, Italian, Turkish, Indian and Chinese companies can have more chance than the others.

**Table 7. The reasons that strategic supplier alliances are not preferred by respondents**

| The causes that strategic supplier alliances are not formed | *N* | *%* |
|---|---|---|
| Diminution of companies' independence | 12 | 57,1 |
| The loss of some suppliers | 8 | 38,1 |
| The loss of operational control | 17 | 81,0 |
| The loss of confidentiality customers' information | 5 | 23,8 |
| The clash of corporate cultures | 11 | 52,4 |
| The deprive companies of future opportunities | 10 | 47,6 |
| The distrust to suppliers | 13 | 61,9 |
| Other (Please specify ………………………) | - | - |

It is important why some respondents are not interested in strategic supplier alliances. According to the research results, the most cited reasons are the loss of operational control, diminution of companies' independence, the distrust to suppliers, and the clash of corporate cultures. The least cited reasons are the loss of some suppliers and confidentiality of customers' information. Thus, they do not want to establish strategic supplier alliances because of keeping their companies' managerial and economic independences (Table 7).

# CONCLUSION

Individual businesses no longer compete as autonomous entities but rather joining to a supply chain alliance due to the highly competitive business situation. Therefore, suppliers, manufacturers, logistic service providers, distributors, wholesalers and retailers in the supply chain always call for stronger alliances, vertically or horizontally, to compete against other supply chains. The high level of interdependence existing among them leads to the creation of true strategic supplier alliances because companies coordinate their activities and help each other to achieve shared objectives (Lin and Chen, 2004; Lajara and Lillo, 2004).

Obviously, according to literature reviews, the competitiveness in global economy requires companies to focus on core competencies, reduce their number of suppliers and develop strong partnership with the suppliers. Supplier alliances, supply chain management and strategic supplier alliances are playing very important role for these requirements, and can prove highly beneficial to the partnering companies in a natural stone supply chain (Lorincz, 1985; Vyas et al., 1995; Stuart and McCutcheon, 1996; Dyer, 1996; Maloni and Benton, 1997; Kannan and Tan, 2004; Famuyiwa et al., 2008; Dalton, 2009 etc.). Undoubtedly, the strategic supplier alliances are not the best solution in many situations. However, the establishing global strategic supplier alliance is a critical strategy to stay competitive for today's business in natural stone industry (Barutçu, 2008). Thus, managers and strategists should shift their focus from strategic alliances among companies or rivals towards strategic supplier alliances involving the owners of quarries, manufacturers, logistic service providers and distributors in the global natural stone supply chain.

According to research results, although respondents have shown a positive attitude towards the strategic supplier alliances, it is important to note that 43,8% of the natural stone distributors or wholesalers are not eager to ally to the natural stone suppliers. The managers of natural stone quarries should work hard to develop strategic supplier alliances with wholesalers, distributors and importers in a global natural stone supply chain. Initially, all strategic supplier alliances should not be designed to achieve mutually beneficial outcomes for all partners. Natural stone companies should establish strategic supplier alliances cautiously and at lower-risk for learning the markets and exploring opportunities.

In the further researches, how the number of strategic supplier alliances can be increased and how strategic supplier alliances are strengthened in the natural stone industry should be analyzed.

# REFERENCES


Barutçu, S. (2008) "Strategic Supplier Alliances in the Natural Stone Industry: The case of Turkish Companies", 4th International Strategic Management Conference, June 19-21, Sarajevo, Bosnia-Herzegovina, 3-10

Booth, J. (2008) The worst U.S. housing crisis since the great depression, Retrieved April 21, 2008 from http://blog.builddirect.com/industryinsights/?p=201

Burgers, W.P., Hill, C.W.L., Kim, W.C. (1993), "A theory of global strategic alliances: the case of the global auto industry", Strategic Management Journal, Vol. 14(6), 419-432

Dalton, C.M. (2009) "Strategic alliances: There are battles and there is the war", Business Horizons, Vol.52 (2), 105-108

Day, G.S. (1995), "Advantageous alliances", Journal of the Academy of Marketing Science, Vol. 23(4), 297-300

Dyer, J. H., (1996) "How Chrysler Created an American Keiretsu," Harvard Business Review, July-August, 42-56

Famuyiwa, O., Monplaisir, L. and Nepal, B. (2008) "An integrated fuzzy-goal-programming-based framework for selecting suppliers in strategic alliance formation", International Journal of Production Economics, Article in Press, Corrected Proof Vol. 113 (2), 862-875

Griffin, R. W. (1999) Management, 6th Edition, Houghton Mifflin Company, MA, USA, p.83

Gürel, C. (2008) İtalyanlar rakip değil partnerimiz olmalı (Italy should be our partners not rivals), Aerstone from Anatolia, Vol. 1 (4), 18

Gunasekaran, A. Lai, K. and Cheng, T.C.E. (2008) "Responsive supply chain: A competitive strategy in a networked economy", Omega, Vol. 36(4), 549-564

Hitt, M. A., Ireland, R. D., Hoskisson, R.E. (1995) Strategic Management Competitiveness and Globalization, West Publishing Company, USA, p.152

Inkpen, A.C., Beamish, P.W. (1997), "Knowledge, bargaining power, and the instability of international joint ventures", Academy of Management Review, Vol. 22 (2), 177-202

Jarratt, D. G., (1998) "A strategic classification of business alliances: a qualitative perspective built from a study of small and medium-sized enterprises", Qualitative Market Research: An International Journal, Vol. 1 (1), 39-49

Kannan, V.R., Tan, K. C. (2004) "Supplier alliances: differences in attitudes to supplier and quality management of adopters and non-adopters", Supply Chain Management: An International Journal, Vol. 9 (4), 279-286

Knoke, D. (2005) "Strategic alliances and models of collaboration", Management Decision, Vol. 43(1), 123-148

Lambert, D. M., Martha C. C., Janus D. P., (1998) "Supply Chain Management: Implementation Issues and Research Opportunities", The International Journal of Logistics Management, Vol. 9 (2), 1-19

Lorincz, J.A., (1985) "Job-One Is Being Done With Statistical Process Control", Purchasing World, September, 34-38

Maloni, J.M., Benton, W.C., (1997) "Supply Chain Partnership: Opportunities for operations research", European Journal of Operational Research, Vol.101, 419-429

Mockler, R.J. (2001), "Making decisions on enterprise-wide strategic alignment in multinational alliances", Management Decision, Vol. 39 (2), 90-8

Monczka, R. M., Petersen, K. J., Handfield, R. B., Ragatz, G. L., (1998) "Success Factors in Strategic Supplier Alliances: The Buying Company Perspective", Decision Sciences, Vol. 29, 553-577

Myhr, N., Spekman, R.E. (2005) "Collaborative supply-chain partnerships built upon trust and electronically mediated exchange", Journal of Business & Industrial Marketing, Vol. 20 (4/5), 179-186

Pett, T.L., Dibrell, C. C. (2001) "A process model of global strategic alliance formation", Business Process Management Journal, Vol. 7 (4), 349-364

Quelch, J. (2008) "Marketing Your Way through a Recession", Harvard Business Online, Retrieved April 8, 2009 from http://hbswk.hbs.edu/item/5878.html

Stuart, F. I., McCutcheon, D. (1996) "Sustaining strategic supplier alliances", International Journal of Operations & Production Management, Vol. 16 (10) 5-22

Stuart, F., I., McCutcheon, D.M., (2000) "The Manager's Guide to Supply Chain Management", Business Horizons, Vol. 43 (2), 35-44

Tekinay, A. N. (2004) "Nişanlılar artıyor- Alliances is increasing" March, Capital, Istanbul

Tsang, W.K. (1998) "Motives for strategic alliance: A resource-based perspective", Journal of Management, Vol. 14 (3), 207-221

Udell, G. F. (2009) "Wall Street, Main Street, and a credit crunch: Thoughts on the current financial crisis", Business Horizons, Vol.52, 117-125

Vyas, N.M., Shelburn, W.L., Rogers, D.C. (1995) "An analysis of strategic alliances: forms, functions and framework", Journal of Business & Industrial Marketing, Vol. 10 (3), 47-60

# AN INVESTIGATION OF CENTRALITY IN THE SOUTH AFRICAN COMPANY NETWORK


**Hamieda Parker and Ian Durbach**
**University of Cape Town, South Africa**


## ABSTRACT


*The main object of this paper is to reconstruct the South African company network – a graph in which nodes represent companies and two nodes are connected by an edge if they have one or more board member in common. The extent of inter-connectivity in this network is evaluated and compared to results found in other countries. We aim to identify the companies that are most central to the network and investigate the relationship between network centrality, market capitalization and sector membership.*


## INTRODUCTION

Many complex systems can be represented by networks – collections of nodes representing entities of some kind, connected to one another by edges representing some form of relationship between the nodes that they connect. Examples from the literature on networks include friendships between individuals (Rapoport and Horvath, 1961; Milgram, 1967), business relationships between companies (Davis,1993; Davis, Yoo and Baker 2003), and co-authorship of scientific papers (Newman, 2001).

In this paper, we consider a specific type of network: one in which the nodes of the network represent companies listed on the Johannesburg Stock Exchange (JSE), and two companies are connected by an edge if they have one or more board members in common. This type of connection between companies is important because, among other things, information about one company may pass freely to the other company via the member sitting on both boards. The examination of such "interlocking" (Mizruchi, 1996) company directorates has been a source of much interest. More recently, and in particular as comprehensive directorship data has become readily available, attention has shifted somewhat to aggregate-level descriptions of the structure of the network as a whole.

One of the most popular research questions in this tradition has been the identification of the nodes in the network that are in a sense the most important or most influential. These nodes are referred to as "central" and, when viewing the set of nodes as a system or collective whole, it is these central nodes that to a large extent determine the structure and function of the collective system.

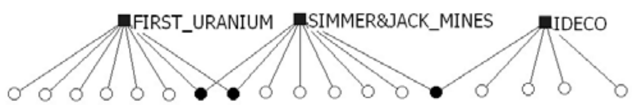
Our aim in this paper is to construct a network of JSE-listed South African companies and to examine the centrality of the companies in that network. In doing so, we evaluate the extent to which companies in South Africa are inter-connected, comparing these results to ones obtained from other countries. We also identify the companies that occupy the most important positions in the broader company network and test for any relationship between the centrality of a company and two further factors: which sector the company belongs to, and its market capitalization.

The paper is structured as follows: in the section *'Representing companies using networks'* we give an overview of social networks and discuss the notion of node centrality. We then describe the company network constructed for this study in the section *'Data'*. The main centrality results are given in the section *'The most well-connected companies in South Africa'*, while a further section *'Centrality and market capitalization'* elaborates on these results by investigating the relationship between firm centrality and market value. The paper concludes with a final *'Conclusions'* section.

# REPRESENTING COMPANIES USING NETWORKS

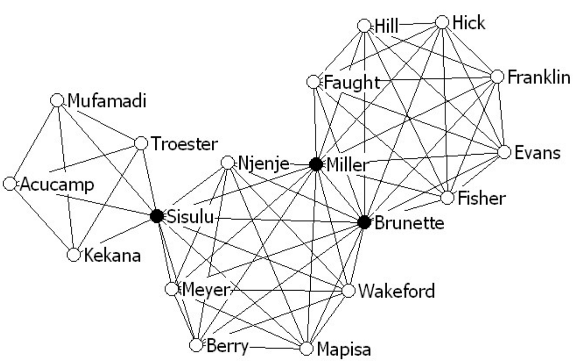
The structure of corporate directorships is that each company possesses a board consisting of a number of directors. There are therefore two types of entities in the system: directors and companies. Both directors and companies can be represented in what is termed a *bipartite graph*, with a connection from a director *i* to a company *A* being present if director *i* is a member of the board of company *A*. Figure 1 shows an example of the bipartite network obtained for a subset of three companies (First Uranium Corporation, Simmer and Jack Mines, and Ideco) from our full dataset. Note that squares indicate company nodes, circles represent director nodes, and that edges cannot exist between nodes of different types (a feature of bipartite graphs). The black circles indicate directors that sit on more than one board.

## FIGURE 1: EXAMPLE OF A BIPARTITE NETWORK OF DIRECTORS AND FIRMS



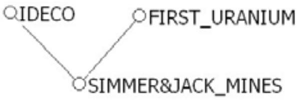

The bipartite network can be used to generate two further networks called *projections*. In the director-projection, only the director nodes are shown, with two director nodes being connected by an edge if they serve together on at least one board. The director-projection for the bipartite graph in Figure 1 is shown in Figure 2.

## FIGURE 2: THE DIRECTOR-PROJECTION OF THE BIPARTITE NETWORK




The second projection is formed using only the company nodes. Two companies are connected by an edge only if they share one or more board members. Thus Ideco and Simmer and Jack Mines are connected because they share one director (Sisulu), while Simmer and Jack Mines and First Uranium Corporation are also connected by an edge because they share two directors (Miller and Brunette). Figure 3 shows the company-projection for our example network. Note that there is some loss of information here: the company network does not distinguish between a pair of firms that shares one director, and a pair that shares more than one director (the same would be true of the director-centric network in Figure 2).

**FIGURE 3: THE COMPANY-PROJECTION OF THE BIPARTITE NETWORK**




The two projections can be analysed in much the same way, and it is relatively common to report results for both the director network and the company network. In this paper we have restricted our attention to the role played by companies in shaping the corporate landscape. This is done because the role played by companies is likely to dominate that played by individuals, and to keep the paper relatively short.

Once the company network has been constructed, we wish to measure each company's position in the network in terms of its importance or centrality. There are several ways to do this. The first is simply to count the number of companies that a particular company is connected to. This quantity is known as the *degree centrality* (or just *degree*) of a node and is perhaps the most widely-used measure of centrality. Companies with higher degrees are connected to a greater number of companies and therefore occupy a more central position in the network. It is also possible to measure the centrality of a node with referring directly to how many companies it is connected to. A sequence of edges connecting two nodes to one another is known as a *geodesic* or *path*. The number of edges making up a geodesic is known as the *geodesic distance* between those two nodes. Often, two nodes may be connected by more than one geodesic – that is, there is more than one way to get from node $i$ to node $j$. If a node is particularly central, it will lie on a large number of the possible geodesics between any two nodes $i$ and $j$. The *betweenness centrality* of a node $i$ is given by the proportion of all geodesics between nodes $j$ and $k$ (over all $j$ and $k$) that pass through node $i$. Both the degree and betweenness centrality measures have been widely used in network studies.

# DATA

The network that we investigate comprises all JSE-listed South African companies as at 1 March 2008. Information on the boards of directors of each of these companies was obtained from the McGregor BFA database and checked manually for consistency. One problem that arises is that companies may provide different levels of detail in the names of their directors, for example in the numbers of initials that are specified. In some cases it is clear that the director is in fact the same person (for example, NJM Canca and NJMG Canca are presumably the same person), but in other cases the correct decision is not clear. Although we do not consider the network of directors, their correct identification is important because two firms are connected only if they have a director in common. Our approach has been to create two datasets, one in which only obvious omissions are corrected and another in which any names which are identical in surname and first initial are treated as the same, unless they serve on the same board (in which case, presumably, they are two different people). The dataset with only obvious errors and omissions corrected consisted of 2747 directors and 397 firms, while the dataset merging further directors consisted of 2653 directors (and the same number of firms). We performed the network analysis on both datasets, but report only the results obtained from the latter dataset. Results do not change materially depending on which dataset is used, and results obtained using the first dataset are available from the authors on request.

# THE MOST WELL-CONNECTED COMPANIES IN SOUTH AFRICA

Table 2 gives the network statistics obtained from an analysis of the company network. The table shows the 20 most highly-connected companies on the JSE ranked according to their degree centrality. The size of each firm's board size, degree per board member, and position in the descending betweenness rank order is also given. Aggregate statistics (over all 397 firms) are given for each of the four measures in the final three rows of the table. The aggregate betweenness statistics refer to the betweenness centralities described previously divided by the maximum possible betweenness and expressed as a percentage.

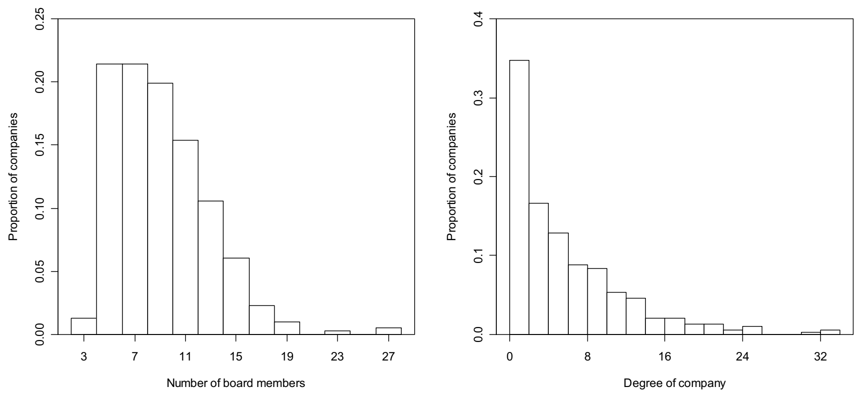
**TABLE 2: THE 20 MOST HIGHLY-CONNECTED FIRMS IN SOUTH AFRICA, AS MEASURED BY DEGREE CENTRALITY.** Aggregate statistics refer to all 397 companies.

| Firm | Degree | Board Size | Degree per board member | Between-ness rank |
|---|---|---|---|---|
| SUN INTERNATIONAL | 33 | 15 | 2.2 | 4 |
| STANDARD BANK GROUP | 32 | 18 | 1.8 | 3 |
| MUTUAL AND FEDERAL | 30 | 17 | 1.8 | 7 |
| BIDVEST | 24 | 26 | 0.9 | 5 |
| IMPERIAL HOLDINGS | 24 | 22 | 1.1 | 1 |
| ABSA GROUP | 24 | 27 | 0.9 | 2 |
| ILLOVO SUGAR | 24 | 16 | 1.5 | 17 |
| FIRSTRAND | 23 | 17 | 1.4 | 10 |
| ASPEN PHARMACARE | 22 | 11 | 2.0 | 6 |
| SANLAM | 21 | 18 | 1.2 | 11 |
| TONGAAT HULETT | 20 | 13 | 1.5 | 30 |
| AECI | 20 | 14 | 1.4 | 9 |
| ANGLO PLATINUM | 20 | 14 | 1.4 | 19 |
| SASOL | 20 | 15 | 1.3 | 13 |
| REMGRO | 19 | 19 | 1.0 | 8 |
| DISTELL GROUP | 19 | 14 | 1.4 | 25 |
| MAKALANI HOLDINGS | 19 | 8 | 2.4 | 20 |
| PICK N PAY STORES | 19 | 14 | 1.4 | 40 |
| MURRAY AND ROBERTS | 18 | 14 | 1.3 | 16 |
| JCI | 17 | 5 | 3.4 | 15 |
| Mean (all firms) | 5.234 | 8.559 | 0.551 | 0.36% |
| Std error | 0.294 | 0.186 | 0.027 | 0.03% |
| Median | 3 | 8 | 0.4 | 0.05% |

A company listed on the JSE is connected to on average 5.2 other firms by virtue of the fact that they share a common board member. This figure is slightly lower but roughly comparable with the average degree centralities of 5.6 and 6.1 found in the United Kingdom and Germany respectively (Conyon and Muldoon, 200?), and somewhat less than the 7.3 found by the same authors in the United States. All three of these networks were larger than the one we study here.

The average, however, can be misleading when considering aggregate degree centrality because of skewness in the distribution of company degrees. In fact, 75 of the 397 companies (19%) are not connected to any other companies (degree zero) and another 63 (15%) are only connected to one other company. The median degree is just 3, and nearly 65% of companies are connected to five or fewer other companies. The full distribution of company degrees is shown in Figure 4 together with the distribution of board sizes. The degree distribution is considerably more skewed to the right than the distribution of board sizes (the skewness of board size and degree distributions is 1.1 and 1.7 respectively).

## FIGURE 4: HISTOGRAMS SHOWING THE DISTRIBUTION OF (A) THE NUMBER OF MEMBERS PER BOARD, AND (B) COMPANY DEGREE.

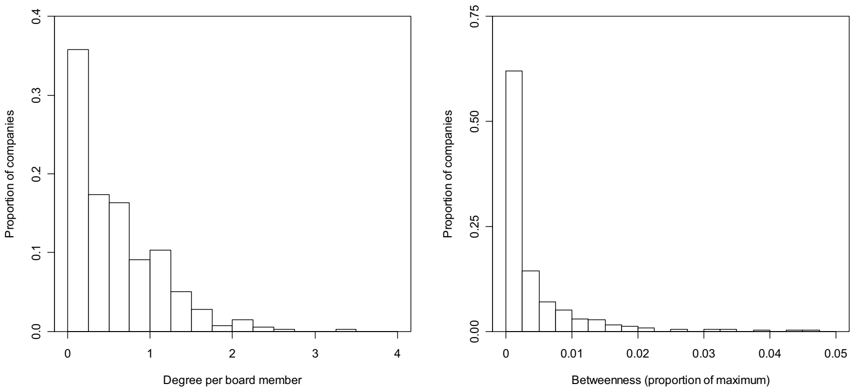



Though the majority of companies are connected to relatively few other companies, there are a small number of companies that are in fact very highly connected. There are some 30 companies (8% of all companies) that are directly connected to 20 or more other companies. Three of these companies have degrees greater than 30: Sun International (33), Standard Bank (32), and Mutual and Federal (30). These firms are in a position of considerable standing within the community of firms – a firm with a degree of 30 shares a board member with nearly 8% of all firms on the JSE.

Having a large board goes a long way to ensuring that a company has a high degree, although it is not the only factor involved. Thus while there is a strong positive relationship between board size and degree (the correlation is 0.662), there are numerous counter-examples too. One of the more striking examples is Sun International, which has the highest degree of companies listed on the JSE but only the 17th largest board size (tied with nine other firms). Makalani Holdings and JCI Ltd. are further examples of firms that occupy highly central positions in the company network despite having relatively small (in these two cases below-average) board sizes. A further useful statistic is therefore obtained by computing the number of connections i.e. degree, per board member. It is interesting to note that some companies with relatively small degrees have some of the very highest per-board member degrees. The companies with the three largest ratios of connections to board members (JSI Ltd., with 3.4 connections per board member; Workforce Holdings, with 2.6; and BSI Ltd., with 2.4) are ranked 20th, 36th and 43rd in the rank order of company degrees respectively. All three of these companies have only five directors sitting on each of their boards. The companies with the ten highest degrees per board member occupy an average rank of 39 in the regular degree rank order. Figure 5(a) shows the distribution of degree per board member – the distribution matches quite closely the form of the degree distribution in Figure 4(b), although it is somewhat less skewed (the coefficient of skewness is 1.4).

A company gains a high degree per board member by having board members that simultaneously sit on many other boards. This may to some extent reflect a strategic decision to elect board members who are currently sitting on many boards. There are several reasons why selecting such directors might be a reasonable strategy, the most obvious of which is that a director who currently holds seats on other boards has been ‘approved’ by others. Another possible reason is that the director may have ongoing first-hand knowledge of sectors and companies that are important to the success of the company in question. Although our data does not allow us to distinguish between boards memberships possessed prior to election to a particular board and those obtained subsequent, the degree per board member figures provide an interesting basis for speculation on these issues.

**FIGURE 5: HISTOGRAMS SHOWING THE DISTRIBUTION OF (A) THE NUMBER OF CONNECTIONS PER BOARD MEMBER, AND (B) BETWEENNESS CENTRALITIES.**




The betweenness centralities have been normalised by dividing by the maximum possible betweenness value.

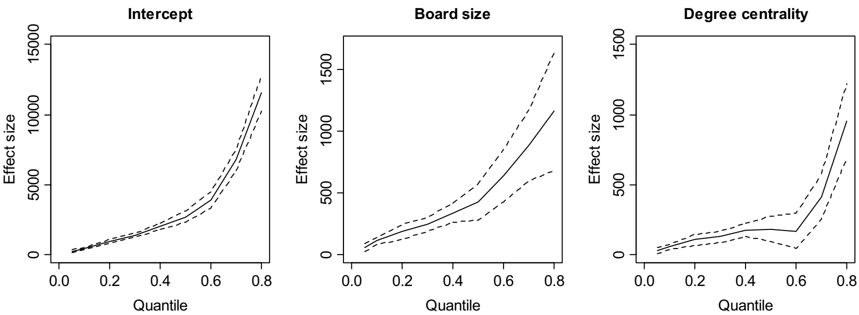
Finally, we consider the alternate definition of centrality provided by the betweenness centrality measure. The full distribution of betweenness centralities, normalized for convenience, is shown in Figure 5(b). It is clear that this distribution is the most right-skewed of the four distributions shown in Figure 4 and 5, and indeed its coefficient of skewness is, at 3.1, substantially larger than the other distributions. Nevertheless, the results provided by the betweenness centrality measure closely match those given by the degree centrality. The correlation between the two measures is 0.85, approximately the same level of agreement as that given between the degree and degree per board member measure. The companies with the 10 highest betweenness centralities all appear in Table 2 (i.e. are among the 20 highest degree centralities), although there are some lower-order anomalies. Notable companies whose betweenness ranking (denoted $R_B$) far exceeds their position in the degree rank order (denoted $R_D$) are Value Group Ltd. ($R_B = 12$, $R_D = 75$), SA Corporate Real Estate ($R_B = 18$, $R_D = 56$), Ambit Properties ($R_B = 23$, $R_D = 121$), and Mvelaphanda Holdings ($R_B = 24$, $R_D = 75$).

## CENTRALITY AND MARKET CAPITALIZATION

In this section we consider the effect of the centrality of a firm's position in the company network on its market capitalization. That is, we ask whether firms that occupy more central positions in the network tend to have higher or lower market capitalization values. In doing so, it is important to control for the effect of board size. Firms with large market capitalizations will tend to require larger boards to manage them, so that one would expect a positive relationship between board size and market capitalization. In fact such a relationship has been shown numerous times (cite?). Since, as we have seen, larger boards also tend to be possess higher centrality, there is an obvious need to control for board size when examining the relationship between centrality and market capitalization.

We do this by fitting a series of quantile regression models (using the quantiles $q$ = 0.05, 0.1, 0.2, 0.3, 0.4, 0.5, 0.6, 0.7, 0.8) to the 378 companies for which we were able to obtain market capitalization information. Models were fitted using either degree or betweenness centrality as a measure of centrality, while controlling for board size. Board sizes and degree centralities were first centered around their means so that the intercept term can be more easily interpreted (Koenker and Hallock, 2001). Figure 6 shows the results obtained from the model using board size and degree centrality as independent variables. The solid line plots the parameter estimates obtained at various quantiles, while the dashed lines indicate 95% confidence intervals around those estimates. The parameter values can be interpreted as the effect of a one-unit increase in the independent variable on market capitalization. Figure 7 shows similar results obtained using board size and betweenness centrality. Because degree and betweenness centralities are attempts to measure the same underlying notion i.e. node importance, as well as being highly correlated with one another, no attempt is made to include both centrality measures in the same model (doing so merely results in one being non-significant).

## FIGURE 6: QUANTILE REGRESSION ESTIMATES FOR THE EFFECT OF BOARD SIZE AND DEGREE CENTRALITY ON MARKET CAPITALIZATION.



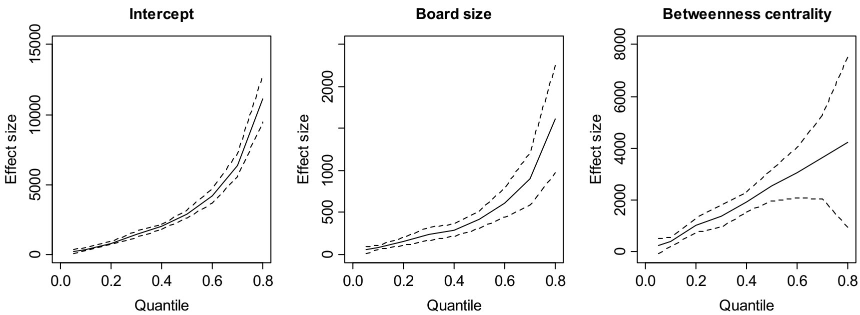

The models verify the positive relationship between board size and market capitalization, though as indicated by the positive slope of the solid line in the Board size plot, this effect tends to be considerably larger in the upper quantiles of the distribution. For example, a firm with 1 more director than another firm has an approximately R50 million greater market value at the 0.05 quantile (i.e. at very low levels of market capitalization), but a R424 million greater value at the 0.50 quantile (i.e. median market capitalization) and over R1 billion greater value at the 0.80 quantile (i.e. at higher levels of market capitalization). Thus, while it appears true to say that in general companies with bigger boards tend to have bigger market capitalizations, the difference between a firm with a small board and one with a big board tends to be far more pronounced at higher levels of market capitalization than at lower levels.

Our models also find a strong positive relationship between degree centrality and market capitalization, even after controlling for the effect of board size. The coefficient of the degree centrality effect is positive and significant at the 1% level over all of the quantiles, indicating that firms having higher numbers of connections to other firms tend to have higher market capitalization. Similarly to the effect of board size, the degree centrality effect is smaller in the lower quantiles of the distributions, increasing in magnitude as the market capitalization quantile increases. At the median quantile, firms with a single additional connection have an approximately R180 million greater market capitalization. At the 5% and 80% quantiles, this figure is R24 million and R954 million respectively. Simply put, the difference in the market capitalization of a highly-connected firm and a poorly-connected firm whose market values are both in the lower quantiles of their respective conditional distributions is not that large. But that same difference can be a full order of magnitude greater when those firms are both in the upper quantiles of their respective conditional distributions. Thus both centrality and the size of a firm's board have larger effects for firms with relatively large market capitalizations. This suggests that limited connectivity and a small board can constrain market capitalization, but that the converse does not necessarily apply to the same degree – being central or having a large board does not ensure high market capitalization. Interestingly, there is a large jump in the magnitude of the effect which occurs around the 0.60 quantile. At smaller quantiles, the centrality effect increases slightly as the market capitalization quantile increases. Beyond the 0.60 quantile, however, the size of the effect increases dramatically. This further suggests that there may be some sort of "critical mass" beyond which inter-firm connectivity exerts it full effect.

Finally, and predominantly for completeness, the intercept may be interpreted as the estimated conditional quantile function of the market capitalization distribution for a "typical" company with 8.65 board members and 5.2 connections to other companies, these figures reflecting the sample mean board size and degree respectively. Thus the 10% quantile for such a company's market capitalization is estimated to be R406 million; the 80% quantile is estimated to be R11.5 billion.

Figure 7 shows similar results obtained using betweenness instead of degree as a measure of centrality. The same general findings are obtained, and so these are not repeated here. Three minor differences from the results obtained using degree centrality are (a) that the effect of betweenness centrality is not significant using the 0.05 quantile ($t$ = 1.47, $p$ = 0.14), (b) that the confidence intervals around the betweenness parameter estimates widen considerably at higher quantiles, particular above $q = 0.6$, and (c) that the increase in the magnitude of the parameter value for the betweenness effect is approximately linear, in contrast to the strong non-linearity observed for the degree centrality parameter.

**FIGURE 7: QUANTILE REGRESSION ESTIMATES FOR THE EFFECT OF BOARD SIZE AND BETWEENNESS CENTRALITY ON MARKET CAPITALIZATION.**




# CONCLUSIONS

In this paper we have constructed a social network consisting of companies listed on the Johannesburg Stock Exchange as at March 2008. Two companies are connected to one another by an edge in the graph if they share one or more common directors. We analysed centrality measures indicating the importance of the role played by companies in the network structure. A list of the most central companies in the South African network was given, and we showed that while the size of a company's board plays an important role in making it central, it is not the only factor. Some companies, by virtue of employing directors that are simultaneously directors of several other companies, are highly central despite having average-sized boards. We introduced a degree per board member statistic to measure this tendency, and showed that companies varied substantially with regard to this statistic. While it is difficult to draw conclusions given the point-in-time nature of the data, it is clear that the selection of such directors (and hence, the degree per board member) may involve some strategic considerations.

The average company on the JSE is connected to 5.2 others in the company network. This is roughly comparable with results reported by Conyon and Muldoon (2006) for the United Kingdom (5.6) and Germany (6.1), though somewhat lower than for the United States (7.3). All three of these other networks were considerably larger than the South African one studied here. Distributions of all centrality measures are heavily skewed to the right, far more so than the distribution of board sizes. This too replicates earlier findings in other countries. The centrality of a firm's position in the company network was shown to be significant related to its market value as measured by its market capitalization. In a series of quantile regressions, we showed that firms that are more central (as measured by either degree or betweenness centrality) tend to have larger market capitalizations, even after controlling for board size, which also has a positive relationship with market value. The results also showed that the magnitude of these effects increases at higher quantiles of the conditional market capitalization distribution. That is, centrality and board size both have larger effects for firms with relatively large market capitalizations. This suggests that limited connectivity and a small board can constrain market capitalization, but that the converse does not necessarily apply – being central or having a large board does not ensure high market capitalization.

# REFERENCES


Conyon M and Muldoon M. The small world of corporate boards. *Journal of Business Finance & Accounting* 33(9-10): 1321-1343, 2006.

Davis G. Who gets ahead in the market for corporate directors: the political economy of multiple board memberships. In Academy of Management Best PapersProceedings, 202-205, 1993.

Davis G, Yoo M, and Baker W. The small world of the American corporate elite, 1982-2001. *Strategic Organization* 1(3): 301-326, 2003.

Milgram S. The small world problem. *Psychology Today* 2(1): 60-67, 1967.

Newman M. The structure of scientific collaboration networks. Proceedings of the National Academy of Sciences 98(2): 404-409, 2001.

Mizruchi M. What do interlocks do? An analysis, critique, and assessment of research on interlocking directorates. *Annual Reviews in Sociology* 22(1): 271-298, 1996.

Rapoport A and Horvath W. A study of a large sociogram. *Behavioural Science* 6: 279-291, 1961.

# WORKING WITH MULTIPLE PARTNERS: BALANCING THE EFFICIENCY – FLEXIBILITY TENSION

**Mariana Dodourova**
**Business School**
**University of Hertfordshire, UK**

## ABSTRACT

*The skill to partner is a transactional competence manifested through the decision whether to make or buy and whether to do so alone or in a partnership. Similarly, the skill to combine multiple cooperative relationships is a transactional competence and a source of competitive strength. The purpose of this study is to investigate whether firms approach the formation and management of their collaborative relationships in a systematic manner to tap synergies and maximise the overall benefits from their partnering activities. A cross-industry qualitative study was conducted in the computer, telecommunications, and media industries (CTMI) to examine how organizations navigate and utilize multiple relationships.*

*Based on the findings, this study proposes a portfolio approach to the management of partnerships in highly dynamic industries. The suggested framework has very tangible meaning in the light of practical management, particularly when a focused interest is emerging in technology-intensive industries towards the art to work with multiple partners. Partnerships are a strategic tool, which has proved very useful in dynamic environments, and practitioners must learn to use them skilfully. The proposed framework is based on qualitative data collected in USA and Western Europe.*

***Key words***: *Partnerships, partnership webs, portfolios*

## INTRODUCTION

The adoption of collaborative agreements as organisational forms of economic activity became increasingly popular during the eighties and increased sharply in the early nineties manifested in the strong growth pattern of the number of partnerships formed annually (Hagedoorn, 1996, 2002). In the overall explosion of collaborations, it has been established beyond doubt that partnerships are mainly concentrated in industries with similar structural properties: research intensive, technology- and investment-intensive, highly concentrated, and risky in the sense of variability of firms' rates of return on equity, e.g. computers, telecommunications, biotechnology, where even the most diversified and resourceful firms need to cooperate to attain the required level of knowledge and complex technology development, achieve scale and scope economies, and reduce the technological and market uncertainty (e.g. Teece, 1992, Wang, 1994, Duysters, 1996, Hagedoorn, 2002). Contributions by, among others, Ciborra (1991), Eisenhardt and Schoonhoven (1996), Gomes-Casseres (1996), suggest that partnerships are valued in the high-technology sectors for their learning and flexibility properties. Moreover, technological complexity makes it necessary for firms in these sectors to collaborate with firms from other sectors to obtain access to new knowledge and complementary technologies that allow for different research and product lines to be followed (Hladik, 1985, Link and Bauer, 1989).

A number of authors have been theorizing about inter-firm collaboration from different perspectives and have identified various reasons for entering alliances. The current explanations are centred on factors such as transaction costs, efficiency, market power, and globalisation. Recently, the notion of core competencies has become very popular, i.e. companies aim to do what they do best and outsource through partnerships. The goal of most alliances has been understood as a means to gain access to new complementary capabilities and technology in order to enrich the firms' innovatory and learning process rather than to enhance the overall prosperity of the partners (Cantwell, 1998; Dyer and Sing, 1998; Inkpen, 1998). A number of partnerships are also created to share risks and costs. As projects become ever larger and more complex, even the biggest companies would rather have partners to share the costs of R&D. Others involve players with complementary operations, for example, a producer and a distributor. Companies with compatible products or services find that they can reduce marketing and sales costs, and potentially increase revenues faster if they work together. Partnerships are said to have such virtues as flexibility, speed, informality, and economy.

Partnerships take many forms, may be transient or lasting, and often live beyond the reach of statisticians. Many options, with differing characteristics, are available to collaborating firms – from short term project based cooperation to long term equity-based cooperation. Under the heading of cooperative agreements the economic and business literature groups a whole array of governance mechanisms: licensing, franchising, subcontracting, consortia, trade agreements, joint ventures, equity and non-equity coalitions and strategic alliances. Joint ventures, however, seem to have become an old-fashioned term. Contemporary partnerships involve many different kinds of organizations, multiple different types of organizational and legal structures. It has been argued that joint ventures, which are less flexible, are primarily found in medium-tech and low-tech industries, where technological development is less turbulent and of a more gradual nature (Hagedoorn, 2002). In contrast, contractual partnerships, which can regulate a flexible setting of multiple partners, have become the norm in high-technology industries where companies often forge partnerships with dozens of other companies and establish webs of both intraindustry and interindustry partnerships. Indeed, companies such as IBM and Oracle have partnering built into their operating plans and spend millions each year to develop partnership programs. Software developers create constellations of collaborations. Hence, a distinguishing feature of many contemporary alliances is that they cannot be understood outside of the broader context of the firm's web of relationships (Doz and Hamel, 1998).

This background suggests that a study of collaborative activities must be sensitive both to the integrity of individual alliances and to the embeddedness of each alliance in the firm's broader range of relationships. The question seems to be no longer whether to form an alliance but how to manage numerous relationships to ensure the most beneficial outcomes for the organization. The skill to partner is a transactional competence manifested through the decision whether to make or buy and whether to do so alone or in a partnership. The skill to combine multiple cooperative relationships appears to have become a source of competitive strength fundamental to survival in the global marketplace. In this context, very interesting, yet unexplored issues are whether firms rationally plan and structure their alliance webs and how strategic consistency is maintained across the firm's partnerships. Despite the abundant theoretical literature on alliances, these questions have been so far largely neglected.

The majority of the extant empirical studies either adopt *the alliance* as a unit of analysis (e.g. Vanhaverbeke and Noorderhaven, 2001, Marshall, 2004, Linnarsson and Werr, 2004) hence dealing with the organizational, strategic, financial, cultural and so on problems within one single relationship or focus on the generalities of alliances established by a number of companies (e.g. Pennings and Puranam, 2000, Bekkers et al., 2002, Miotti and Sachwald, 2003). Although very useful in certain aspects, the former approach greatly limits the complexity and dynamism of the strategic context in which relationships and firms are embedded. The later approach, on the other hand, typically results in a snapshot of relationships between few variables, assuming away some of the complexity in interorganizational relationships. It is questionable whether the true strategic meaning of partnerships can be observed if the relationships are analysed outside of their context.

This study argues that it is important to see each partnership as a function of the firm's overall configuration of strategic choices and relationships. Against this background, the aim of this study is *to investigate whether firms approach the formation and management of their collaborative relationships in a systematic manner to tap synergies and maximise the overall benefits from their partnering activities.* Synergies are understood here as relatedness (Rumelt, 1974) and complimentarity between partnerships, which result in their combined contribution to the firm's performance being greater than the sum of their separate contributions. The areas of relatedness that have the potential for creating synergy can be organized into three categories: synergy by leveraging resources, i.e. achieving resource reallocation and resource replication; synergy by aligning positions, i.e. improving bargaining position and competitive position; and synergy by integrating activities, i.e. sharing or linking value-adding activities (De Wit and Meyer, 2005).
The computer, telecommunications and media industries (CTMI) were selected as a focal point of this research for their technology-intensive properties and high density of collaborative relationships.

# THEORETICAL BACKGROUND

There is a vast literature that attempts to explain, from a theoretical perspective, why firms enter into partnerships and what are the implications of such relationships for the partners, the industry, and the society at large. Two broad categories of literature are considered to have influenced partnership studies most significantly: the transaction costs view and the strategic management view. Both streams focus on the internal organization of the firm's activities in the context of markets or industries respectively. However, while the transaction costs arguments emphasize the importance of rational calculation and efficiency, management theorists have traditionally focused on the firm's strategic intent and the sustainability of its competitive advantage.

## Transaction Costs Approach

Generally, transaction cost theory investigates how firms can increase efficiency by using different ways to organize a transaction, including arm's length markets and internal administrative organizations or hierarchies (Williamson, 1975, 1985). Hence the relative costs of carrying out a transaction under each organizational structure determine the boundary between the market and the firm (Coase, 1937; Williamson, 1975). The most appropriate governance mechanism is selected according to its efficiency in managing transactions with the lowest possible costs. Partnerships are a hybrid form of organization between the market and the hierarchy because they partially internalise an exchange (Williamson, 1985) and will be preferred 'when the transaction costs associated with an exchange are intermediate and not high enough to justify vertical integration' (Gulati, 1995, pp. 87). Partnerships are deployed when internalisation cannot be implemented for lack of resources or presence of institutional barriers, or when arm's length transactions cannot cope with complexities, e.g. in sharing R&D activities or when the subject of exchange is specialized, intangible, inimitable, or embodied in organizational routines (Williamson, 1975, 1985).

The main drawback of the transaction cost approach is its preoccupancy with the importance of rational calculation in understanding organizational structure and practice. It gives little attention to the possibility that outcomes may reflect the concentration of power among some actors, such as corporate managers, rather than efficiency. The later argument is particularly relevant to partnerships where decisions are often made not on efficiency basis but rather on the basis of 'social networking'. All economic relations require an overlay of social relations and vertical integration occurs in the absence of such relations (Granovetter, 1985).

Moreover, the transaction costs view predominantly envisages the incremental growth of the firm while in industries characterized by rapid development of new products and technologies immediate benefits are often gained at the expense of future technological dynamism and things do not proceed only incrementally. In those dynamic industries the risk of missing a market opportunity is reputed to be higher than the hazard of giving up proprietary know-how. Most scholars now accept the prescience of Schumpeter's (1942) observation that competition posed by new products is fundamentally more important than that of marginal changes in the prices of existing products. In fast-moving industries partnerships provide a shortcut to radical change and a primary mechanism by which firms formalize their links to external sources of development (Wilson, 1987). Therefore, transaction costs may be more relevant in some types of partnerships while in others the strategic aspect may be more relevant, e.g. in the form of gains from future positional advantage.

## Strategic Management Approaches

The fundamental question in the field of strategic management is how firms achieve and sustain competitive advantage. The most influential approaches taken by strategic management scholars with regard to partnerships can be broadly arranged into three categories: resource dependence theory, dynamic capabilities school, and business networks theory.

*Resource dependency theory* is a rational choice theory and, like the transaction costs theory, rests on the assumption that organizations principally base their decisions upon economic efficiency. However, unlike traditional industrial economics, which rely heavily on the analysis of the competitive environment, the resource-based view focuses on the efficient management of the resources possessed by the firm in order to attain competitive advantages (Grant, 1991, Peteraf, 1993). The ways in which firms combine and utilize resources influence their adaptation to the environment (Hannah and Freeman, 1977). Performance is based on the strategic differentiation that a firm achieves in the marketplace through developing 'a bundle of unique resources and relationships' (Rumelt, 1984, pp. 557), which cannot be easily imitated by competitors.

Imperfect mobility, imperfect imitability, and imperfect substitutability have been identified as resource characteristics fundamental to partnership formation (Barney, 1991; Peteraf, 1993). Imperfect mobility refers to the difficulty, as well as the nontrivial costs, of moving certain resources from one firm to another. For example, some resources, e.g. firm reputation and organizational culture, are simply not tradable while others, e.g. tacit knowledge, lose much of their value if moved from their current organizational context and resources used in conjunction. Whereas imperfect mobility is concerned with barriers to getting the resources from the owners, imperfect imitability and imperfect substitutability refer to barriers to obtaining similar resources from elsewhere (Barney, 1991; Peteraf, 1993). Finally, causal ambiguity, or the lack of transparency about how a particular bundle of resources are responsible for competitive advantage, constrains imitation and substitution, and augments the need for partnering (Lippman and Rumelt, 1982). Hence, partnerships are employed as mechanisms to secure access to scarce resources (Pfeffer and Salancik, 1978) or extract further rents from existing resources, for which market transactions are difficult to organize. Partnerships are a means of resource accumulation (Kogut, 1988), which evolve on the basis of the rational choices managers make in response to environmental changes and uncertainty.

The *'dynamic capabilities'* approach to corporate strategy introduced by Teece and Pisano (1994) underlines the importance of dynamic change and corporate learning. The literature on dynamic capabilities is tightly related to the resource-based view of the firm and is often referred to as a part of it (Hodgson, 1998). The development of this framework flows from a recognition that strategic theory is replete with analyses of firm-level strategies for sustaining and safeguarding extant competitive advantage but has performed less well with respect to assisting the understanding of how and why some firms succeed in building competitive advantage in regimes of rapid environmental change while others do not. Teece et al. (1997) define dynamic capabilities as the firm's ability to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments.

The dynamic capabilities approach views partnerships primarily as organizational modes that facilitate the transfer of knowledge and corporate learning (Hamel et al, 1989; Kogut and Zander, 1993), a means of internalising core competencies, and a route to acquire the skills of another firm (Hamel, 1991). It is not so much the cost of the knowledge transfer (which would be the focus of the transaction cost approach) but the effectiveness of the transfer that creates the need for collaboration. Partnerships enable firms to learn and enter new technological areas (Dodgson, 1991), and to deal more effectively with technological and market uncertainty. In sum, partnerships are an important part of the firm's learning process whereby the firm discovers new opportunities in a flexible setting of a multitude of changing partnerships. However, despite its emphasis on knowledge accumulation, this approach sheds little light on the issue of information valuation in potentially knowledge-rich partnership, e.g. early on in an alliance, its participants cannot be certain about the future value of the knowledge that might be gained from collaboration.

Finally, a number of authors have proposed that the main competitive advantage of contemporary firms stems from their participation in networks of units. The *network perspective* (Johanson, 1987, Hakansson, 1989, 1992, Jarillo, 1993, Forsgren and Johanson, 1994) attaches considerable importance to the social and cognitive ties that are formed between firms engaged in business relationships in industrial markets. The development of firms' operations is seen as strongly influenced by gradually developed collaborative relationships. Hence, a major objective of the network analysis is to reveal how business processes shape and are shaped back by network structures (Forsgren and Johanson, 1994). Activities performed by one agent have to be continuously adapted to the needs of the others in the network and vice versa (Hakansson, 1989). Thus the business network approach stresses on-going interaction rather than strategic decision-making (Johanson and Vahlne, 1990).

Three categories of theoretical rationale explain the formation of strategic networks: efficiency, synergy, and power (Jarillo, 1988). Networks can achieve efficiencies via scale and scope economies and via the reduction of transactional inefficiency in the open market. The network arrangement allows the firm to concentrate on those parts of the value chain that better reflect its competitive advantage. Thus firms within a network are able to capture the benefits of specialization, focus, and scale. Networks achieve synergies through linking and exploiting the different competencies of a group of firms within a quasi-organizational framework (Miles and Snow, 1984). Thus, similarly to the dynamic capabilities view, the notion of business networks implies that contemporary firms compete primarily on the basis of combining competencies and capabilities. The network is a new form of organization and strategy. Successful firms embed themselves in webs of cooperative relationships, developing strategies together with their partners and competing against other networks (e.g. Gomes-Casseres, 1996, Weidenbaum and Hughes, 1996). Firms are proactive agents who strategically manage their relationships to reduce uncertainties, gain competitive advantages, avoid costs, and manipulate resource exchange. A combination of multiple cooperative relationships can be deployed as a source of competitive strength.

Fifty years ago scholars in economics and sociology struggled with the complexity and multifaceted character of partnerships and viewed them from a singular perspective based on a researcher's host discipline (Warren, 1967). The field has progressed since from a series of disciplinary bases towards more integrated theory approach to alliances. Any literature taxonomy is partially an arbitrary exercise, and the one presented here is no exception. Contemporary authors recognize that partnerships are evolutionary and complex institutions and use a mix of theoretical perspectives to understand the formation, evolution, operation, and outcomes of partnerships.

Indeed, the theoretical approaches outlined above have often used arguments from one another to support various arguments. In this sense, they can be seen as complementary rather than mutually exclusive. The core concepts from the four schools of thought discussed here can be seen as illustrating the multidimensionality of interorganizational relationships, namely: (1) partnerships are a hybrid form of organization, which partially internalises the transaction and is used when internalisation is not possible for lack of resources or presence of institutional barriers; (2) they are also mechanisms for creating the most value out of the firm's existing resources by combining them with other firms' resources; (2) partnerships are vehicles facilitating the transfer of knowledge and corporate learning, and the internalisation of core competencies; (3) and they are a form of organization focused on achieving efficiency, synergy, and power, and managed strategically by the organization. The first two concepts focus on efficiency and rational choice, while the latter two concepts emphasise the flexibility of a multitude of partnerships. All in all, the theoretical debates focus on what is the organizations' primary goal for engaging in collaborative relationships, whether they should do so, and to what extent. In the mainstream literature these debates have been referred to as the paradox of competition and cooperation (De Wit and Meyer, 2005).

However, even the advocates of the embedded organization perspective engage little with the question of *how* organizations can manage numerous relationships to maximize the benefits from cooperation. Indeed, are organizations proactive agents who strategically manage their webs of relationships to tap synergies and, if so, how is this done in practical terms? These questions appear to be particularly relevant in dynamic technology-based industries where the question is no longer whether to cooperate but how to work successfully with multiple partners.

# METHODS

This study is concerned with the need to gain a full and true understanding of reality, rather than the need to establish universal applicability. Hence a qualitative methodology, capable of capturing the perspective of the players, was considered most appropriate. To account for inter-industry variations, a comparative research design was adopted.

## Research Instrument & Selection of Respondents

Face-to-face semi-structured, open-ended, in-depth conversational interviewing was adopted for this study because it has the potential to generate rich and detailed accounts of the interviewed individuals' experience. It is also flexible enough to allow the discussion to lead into areas which may not have been considered prior to the interview but which may be potentially relevant to the study. There is no definitive answer in the literature to the question how many in-depth interviews should be conducted. However, thirty interviews are considered typical (Oppenheim, 1994). Guiding questions were prepared to reflect insights gained from the reviewed industry and academic publications. The questions were purposely designed in most general terms to allow conducting multiple site research and generating data comparable across industrial sectors.

In terms of region, the research focused on Western Europe and US, which together represent a diverse collection of technically and economically advanced countries where: (a) the CTMI are characterised by intense competition; (b) CTMI companies are at the frontier of new technology developments; and (c) CTMI markets in these countries are well developed. To incorporate variations in size and profitability, a diverse sample of US and Western European companies was identified through the *Hoover's* online database whereby major industry type was defined at the four-digit SIC code level.

It is often problematic for the researcher to identity a key informant who can provide the most relevant information. The choice of respondents for this study reflected the requirement that these individuals were involved in or very much aware of their company's partnering activities and strategic decision-making. Hence senior executives responsible for partnership operations and strategic planning were targeted as respondents.

## Data Collection

Thirty-five interviews were conducted in thirty companies (Table 1). The data collection was completed over a five-month period. Eighteen of the companies were domiciled in the US and twelve in Western Europe.

The interviews were tape-recorded and transcribed for analysis into 448 single-spaced typed pages. Each interview began with brief professional histories of the interviewees. These narratives were used as bases for follow-up questions for the remainders of the interviews. The interviews ranged in length from 60 to 180 minutes. Interviewees were encouraged to develop their views around the open-ended questions. Recorded data were transcribed in full directly following each interview in an effort to ensure as much accuracy as possible in terms of their interpretation.

It must be noted that the conducted interviews captured a broad picture of alliance formation and implementation because most of the respondents had occupied senior positions in a number of companies not only within their industry but also in other industries and were able to reflect on their overall experience.

Table 1 Data Collection - Summary

| *Industry* | *US* | **Europe** | **Total** |
|---|---|---|---|
| **Computer** | **10** | **0** | **10** |
| **Telecom** | **4** | **9** | **13** |
| **Media** | **4** | **3** | **7** |
| **Investors & Analysts** | **4** | **1** | **5** |
| **Total:** | **22** | **13** | **35** |

## Data Analysis

Qualitative data analysis most generally comprises a searching out of underlying themes in the materials being analysed. Experienced qualitative researchers have expressed a number of concerns regarding the use of ethnographic software for qualitative analysis, most importantly fragmentation of the textual materials resulting in loss of the narrative flow of interview transcripts and events, and decontextualising of the data (for a list of opinions see Bryman and Bell, 2003, pp. 446). It is, in fact, widely accepted that most of the features that might be needed in conducting qualitative data analysis are achievable through powerful word-processing software such as Word for Windows (Maylor and Blackmon, 2005).

Unstructured approach to the data analysis was adopted for the purposes of this research, using Kolb's learning cycle model to assist the process. The Kolb's learning cycle adopts a pragmatic approach, suggesting that learning takes place as a continual movement from concrete experience to reflective observation, to abstract conceptualiztaion, to active experimentation and back to concrete experience (Kolb, 1985).

The comparative nature of this research required the interview data to be initially broken down into categories corresponding to different aspects of partnership formation for each of the three industries in order to look for patterns and reoccurring events and behaviours. Consequently, more general expressions of the categories were formulated to sum up patterns of behaviour. The responses were coded according to industry and numbered for identification. For validation purposes, most of the respondents were given copies of the provisional analysis, and their opinion was asked with regard to the truthfulness of the interpretation and the developed suggestions.

# FINDINGS & PROPOSITIONS

In concert with previous research (e.g. Gomes-Casseres, 1996, Weidenbaum and Hughes, 1996, Doz and Hamel, 1998), the findings show that firms in CTMI develop numerous partnerships, which enable them to respond to unfolding events quickly and adequately, to maintain or improve competitive position, and to ensure further growth while retaining flexibility. Yet, contrary to the business network perspective, which portrays firms as proactive agents who strategically manage their networks, this research has found that few firms have a systematic approach to partnerships. No significant industry variations were found. However, the findings were found to vary according to the size of the studied organizations. Indeed, previous research have found that large firms resort more to cooperation and the reasons for cooperation differ as between large and small firms (e.g. Bayona et al., 2001).

The few firms that were found to have a clearly defined strategy and a structured approach towards partnerships were typically large while SMEs usually adopted an *ad hoc* approach. Most often there was no actual strategic alignment of the company alliances neither at the business level nor at the corporate level. Firms typically planned and evaluated each partnership separately to fill gaps in product lines, extend geographical reach, or bring better component versions but there was very little evidence that any effort was made to capitalize on potential synergies. The strategic positioning of the collaborations to one another was unclear, and there were co-ordination problems.

The data, however, indicate that, regardless of their size, firms recognize the need to replace the opportunistic approach to collaboration with careful planning, monitoring and coordination. Even firms, which adopt an *ad hoc* approach towards partnerships, realize that a web of well-synchronized partnerships would permit them to better utilize their resources and manage their markets. Yet, at present this realization remains wishful thinking. Despite the realization that partnerships tend to bring much more value if they are closely coordinated, even the large enterprises that make attempts to synchronize their collaborative activities do not devise these configurations as strategic tools. Although firms do develop criteria for partner selection and recognise the potential benefits from a systematic approach, partnerships are still conceived in a rather opportunistic way. Naturally, the every-day management of partnerships is performed on an individual basis.

Moreover, the data suggest that some major challenges arise when a firm participates in a number of partnerships. These challenges are mainly related to the need to deal with the often contradictory interests of the partners. The problem becomes even more complicated when some of the partners are, in fact, competitors between themselves.

## *Partner Selection*

Seabright et al. (1992, pp. 124) note that the criterion for partner selection is 'the fit between one organization's resource needs and another's resource provision, relative to an opportunity set.' Indeed, the data suggest that the partner selection stage is a combination of rigorous assessment processes and opportunity. Firms approach this stage in a rational way and establish unambiguous selection procedures to increase the chances of teaming up with a suitable partner and, hence, increase the chances of partnership success. The selection process starts with defining the goals and objectives that the firm aims to achieve. Potential partners are identified in the targeted markets and grading criteria are developed according to the particular strategic objective. The partner selection is then conducted at two levels: the relationship level and the company level.

The selection at the relationship level is a combination of immediate commercial considerations, such as revenue sharing and marketing contribution, and assessment of the long-term value and opportunity associated with the particular partner. Generally, the ranking starts with assessing the distinctive competitive advantages of the potential partners, for example unique position in the market place, global presence, unparalleled products, ability to provide new ways for delivering products to consumers, or capacity to take their allies into new markets. The potential partner must have technology, capabilities or processes that can contribute to the development of joint output, which will create value for the firm's customer base. The value of the potential partner is also related to the possibility to collaborate on more than one project or in more than one area. The ranking at the relationship level is completed with assessing the impact of each potential partnership on the firm's existing relationships and the balance of power in the potential partnerships. These findings indicate that organizations do recognize at some level the interactive properties of their relationships and the need to make full use of their potential.

At the company level, a promising partner should be able to demonstrate financial stability; good reputation and credibility; integrity and reliability; flexibility; strategic, organisational and cultural fit; and a track record of productive success in partnering. Limited experience in partnering is recognised as largely contributing to the potential partner's perceived uncertainty, which in turn affects the level of trust between the partners. The later is particularly important if the organization is engaged in multiple collaborative relationships. Finally, personal networking and geographical proximity are considered. Geographical proximity is particularly relevant in the case of long-term supplier-buyer partnerships, in which constant interaction and support is often required.

Collaborating with key competitors or sharing partners with them is avoided. Hidden competitive agenda can destroy even the most promising collaboration. The far-reaching consequences of such collaboration must be thoroughly evaluated and perhaps only the prospective partner with the greater potential - should be considered. Collaboration with competitors is also avoided, particularly if the collaboration project concerns a market, which is core for both the firm and the potential ally. Some competitive overlap is acceptable as long as it is limited, not extremely intense, and it is not the core business of the partners. Pre-market cooperation with competitors is also acceptable if the benefits significantly exceed the risks. If a partnership with a competitor is formed, project segregation is imposed and the boundaries between the areas of cooperation and competition must be clearly defined as precautions against opportunistic behaviour.

Using these criteria, the potential partners are ranked against the company objectives according to their short term and long term potential to help the firm achieve its goals. New technologies must not be necessarily forced through existing partners because they might not be the best fit. Partner segmentation for every new product and every new technology ensures the selection of the most suitable ally for each particular project. The partner segmentation and selection take place at the business strategy level. Once a decision has been made, the responsibilities for building, managing and monitoring the partnership are delegated to the relevant business unit.

However, despite the rigorous assessment processes in place, there is little evidence that organizations employ any systematic approach to ensure coordination and synchronization of their partnerships that can deliver synergetic effects in terms of leveraging resources, aligning positions or integrating activities.

## *Portfolio Approach to Partnerships*

The portfolio approach originates from the financial literature and argues that if there is a sufficiently large number of projects or assets in which to invest and if the returns of these assets are independent of each other, i.e. risk is unsystematic, then the simplest risk management device is to diversify. In other words, the firm can develop a portfolio of assets sufficiently large for the possibilities of gain to offset the possibilities of loss. Theoretically, if one asset falls in value, this is countered by a rise in the price of another. If the number of assets is insufficiently large, however, the mechanism does not fully remove the risk. This argument can be applied to any portfolio of assets, including partnerships, whereby even if the number of partnerships is not sufficient to fully remove the risk of failure, the portfolio approach will, in theory, reduce the risk and improve the overall performance of the firm's collaborations.

Examining the applicability of the portfolio approach to the firm's partnerships starts with the assumption that the firm's ability to develop core competencies is constrained and limits the feasible degree of product and market diversity it can achieve. This is the argument for the need of the firm to focus on its core competencies. Yet, numerous firms have assets in a variety of product markets and geographical markets. Unless the firm operates a multidomestic strategy, whereby its operations in across national boundaries are completely autonomous and independent of each other, these assets are likely to be all linked in the firm's value chain. Essentially, this means that poor performance in one area will inevitably have an impact on all areas, i.e. in most situations all risk is systematic and cannot be completely removed. Nevertheless, if a particular product market is exhausted or further growth is limited, the firm must introduce new products or reach into new markets in order to continue growing. With a balanced portfolio of products at different points of their life cycle the firm can sustain its growth. Moreover, at any time the firm must be able to simultaneously introduce new products and cease the production of old ones. This is the logic behind the product portfolio approach in the strategic management literature and this logic can be transferred to the design and management of partnership webs.

Most firms in technology-intensive industries have more than one partnership. The findings of this research show that this holds true for different sets of partners, e.g. a firm usually has more than one supplier or more than one distribution partner, etc. Some large firms have dozens or even hundreds of partners. Thus the relationship perspective on partnerships is a limited one while the portfolio perspective offers a number of advantages in planning and managing the firm's alliances. This research confirms that, indeed, organizations are beginning to recognize that fortifying their businesses with multiple collaborative relationships along the value chain can deliver superior combinations of technology and product development, functional integration, marketing and distribution, service and maintenance.

Above everything else, however, the portfolio approach is a risk minimising device, which can be very useful in the context of increasing technological, product and market uncertainty in the CTMI. Partnerships often take long to develop and even longer to deliver financial benefits. In addition, there are great variations between relationships in terms of duration and productiveness. Applying the portfolio approach to partnerships can greatly contribute to the efficient utilization of the value-creation potential of the firm's resources through allowing synergetic access to multiple markets, assets and capabilities, and through securing risk and revenue distribution. Managing the firm's partnerships as a portfolio can act as a flexible platform for integrating the core technologies and capabilities of the firm and its partners.

The first step towards developing a systematic approach to alliance management must be to distinguish between the different levels of partnering activities. The scrutiny of the data suggested that the collaborative relationships need to be planned, monitored, and evaluated at three levels: (1) *Dyadic level*, i.e. a single relationship between two companies. Dyadic ties are often overlapping, e.g. two firms can form between themselves a number of contractual alliances with different scope and purpose; (2) *Partnership level*, i.e. the partners and relationships within an individual alliance. Many alliances are formed by more than two partners and comprise of a number of dyadic relationships; and (3) *Partnership web level*, i.e. all the collaborations of the firm or the business unit. To function as a portfolio, the goals, resource needs, and potential benefits, including revenues, of the firm's partnerships must be coordinated at the partnership web level. While the business strategy will have to consider the management and utilization of all three levels, the corporate strategy will be mainly concerned with the partnership web level.

The next step in designing a portfolio is to articulate the issue of choice. The most common approach is to use a matrix such as the Growth Share matrix. One way to categorize the firm's partnerships is according to type of value chain activities, e.g. Sales, Product & Technology Implementation, R&D, and Services & Production (Exhibit 2). The basic idea is that the portfolio management of partnerships should focus on achieving synergetic effect through leveraging resources and aligning positions across the value chain activities, linking and sharing them where possible. The overall configuration of the portfolio, including new partner selection and effort invested in particular partnerships, must reflect the strategic direction of the organization.

To complete the matrix, some basic partnership profiles need to be outlined. For instance, qualified partnerships, key partnerships and top partnerships can be distinguished to cater to the requirements, area of activities, scale and contributions of each partnership, and level of capabilities of the partners. Qualified partnerships will incorporate alliances on a national scale which are limited to only one of the four activity categories. Key partnerships will be considered the ones that cover more than one category of activities, e.g. joined R&D and product/service offerings. The partners in this category will be transnational companies and key players in their market segments. Finally, top partnerships will be considered the ones with a high degree of strategic relevance. These partners will be international market leaders, which cooperate with the firm across several activity categories, and implement jointly defined business goals based on agreed balance scorecards. Further categorisation may be appropriate, for instance, according to resourcing and financial performance to assist the optimisation of the firm's resource planning. It must be noted that this portfolio layout is suggested only for illustration purposes. The appropriate layout of the particular firm's alliance portfolio will depend on the firm's strategy focus, size, organizational structure, scope and diversity of activities.

The findings of this study show that organizational fit is considered one of the important criteria for partner selection. Organizational fit implies that the partners' strengths and weaknesses are dissimilar and, hence, complementing one another and producing a synergetic effect. Companies with identical strengths are likely to suffer disagreement over their respective contributions to the partnership, while allies with identical weaknesses will suffer from lack of essential resources. For instance, a marketing collaboration requires both partners to have strong marketing capabilities but they must differ and complement each other in product lines, customer bases or distribution channels for the collaboration to work. In reality, there will be always areas where either a necessary strength is missing or there is an organizational overlap. It is paramount, however, to identify the missing strengths beforehand and examine the possibilities of offsetting against them in order to minimise the organizational misfit. Similarly, for the overlapping areas the partners should look into possibilities to leverage their combined resources rather than begin power games.

## Table 2 Alliance Portfolio Matrix (example)

| Profiles / Value chain activities | Qualified partnerships | Key partnerships | Top partnerships |
|---|---|---|---|
| **Sales** | | | |
| **Product and technology** | | | |
| **R&D** | | | |
| **Services and production** | | | |

Continuous monitoring and coordination of the alliance portfolio can deliver significant synergies across partnerships and across value chain activities hence contributing to the more efficient utilization of the partners' resources. The positioning of the alliances to one another must be clear to reassure the partners and assist the building of trust. The performance of the individual alliances must be constantly monitored and assessed to ensure timely intervention if necessary and investigation into the reasons for underperformance. Portfolio monitoring has the potential to screen for improvement in the potential of existing partnerships and opportunities for extending the relationships to another area or business unit, to stimulate the development of selected key partnerships, to establish best practices, and initiate processes of learning and change.

Last but not least, partnering is complex and hard, and this study has found that it requires constant balancing not only within and across relationships but also across the firm's departments. Ongoing interaction and coordination must apply between the management of the different partnerships and groups of partnerships as well as between the firm's internal businesses and divisions. Firms must be aware of conflicts at three levels: (1) internal competition between the business units within the firm for a particular partnership; (2) conflicts between the firm and its partners; and (3) tension among the allies of the firm, typically caused by uncertainty over market interests and business practices. There is no single formula for resolving these conflicts but, generally, looking into them on a case-by-case basis while considering the overall balance of benefits both within and across relationships, having more than one partner but not too many in each area, negotiating acceptable compromises, keeping customers' needs in the forefront, and not engaging in exclusive deals, might prevent some problems.

To conclude, the corporate strategy ought to provide the general framework for partnering activities through balancing the strategic goals, the general resource allocation and the financial potential of the partnerships as a portfolio. The business strategy, on the other hand, will be responsible for the day-to-day management, control, monitoring and implementation in addition to the financial and strategic portfolio coordination within the business unit.

## CONCLUSIONS

Alliances are first and foremost, strategic vehicles for accomplishing vital corporate objectives. As previous studies have suggested (e.g. Katila and Mang, 2003), the ability to collaborate has a learning curve and is an important transactional competence with tacit dimension, which directly impacts the competitive strength of the firm. The industry patterns of competition and demand differ; hence there are variations in the importance of partnerships, their processes and structures. Hence it is difficult to formulate what is best in collaborating activities – one size will not fit all. Neither it is valuable to look at partnering activities only as sequences of rational well calculated moves because such approach lacks understanding of the vision, the value proposition, and the interactions between both organizations and individuals. Nevertheless, a balanced systematic approach to partnerships will allow firms in dynamic technology-intensive industries to manage more efficiently their resources and their markets, and to balance the tension between efficiency and flexibility.

This study proposes that the firm's web of collaborative relationships can be systematically employed as a way of organizing to widen the range of options, technological and strategic, available to the firm. A portfolio approach to the management of partnerships in dynamic technology-intensive industries will have very tangible meaning in the light of practical management, particularly when a focused interest is emerging in those industries towards the art to work with multiple partners. Business leaders make decisions under conditions of great uncertainty in an attempt to anticipate changes and stay ahead of the technology curves changing their environment. The ability to innovate and further develop and apply new technologies is fundamental to building strength and power critical to business success and survival in the global marketplace. Partnerships are a strategic tool, which has proved very useful in such environments, and practitioners must learn to use them skilfully. Balancing numerous relationships require development of particular capabilities and must be incorporated in the strategy literature.

# REFERENCES

Barney, J.B. (1986) *Strategic factor markets: expectations, luck, and business strategy*, Management Science, 32 (10), pp. 1231–1241

Barney, J.B. (1991) *Firm resources and sustained competitive advantage,* Journal of Management, Vol. 17, pp. 99 – 120

Barney, J.B. (1992) *Integrating Organizational Behaviour and Strategy Formulation Research*, in P. Shrivastava, A. Huff and J. Dutton (Eds.), *Advances in Strategic Management*, 8, pp. 39 – 61, JAI Press

Bayona, C., García-Marco, T., Huerta, E. (2001) *Firms' motivations for cooperative R&D: an empirical analysis of Spanish firms*, Research Policy Vol. 30, Iss. 8 , pp. 1289-1307

Bekkers, R., Duysters, G., Verspagen, B. (2002) *Intellectual Property Rights, Strategic Technology Agreements And Market Structure*, Research Policy, Vol. 31, Issue 7, pp. 1141 – 1161

Bryman, A. and Bell, E. (2003) *Business Research Methods*, Oxford University Press, New York

Cantwell, J.A. (1998) *Introduction*, Journal of Economic Behavior and Organisation, 35, pp. 133–137

Chandler, A.D. (1977) *The Visible Hand: The Managerial Revolution in American Business*, Belknap/Harvard University Press, Cambridge

Ciborra, C. (1991) *Alliances as Learning Experiments: Cooperation, Competition and Change in high-tech industries*, in L. Mytelka (ed.) *Strategic Partnerships and the World Economy*, pp. 51 – 57, Pinter

Coase, R.H. (1937) *The Nature of the Firm,* Economica (New Series), 4, November, pp.386 – 405

Cohen, W. and Levinthal, D. (1989) *Innovation and learning: the two faces of R&D*, The Economic Journal, 99, pp. 569–596

De Wit, B. and Meyer, R. (2005) *Strategy Synthesis,* Thomson Learning

Doz, Y. and Hamel, G. (1998) *Alliance Advantage: The Art of Creating Value Through Partnering*, Harvard Business School Press

Duysters, G. (1996) *The Dynamics of Technological Innovation*, Brookfield, VT: Edward Elgar

Dyer, J.H. and Sing, H., (1998) *The relational view: co-operative strategy and source of interorganisational competitive advantage,* Academy of Management Review, 23, 4, pp. 660–679

Eisenhardt, K. and Schoonhoven, C. (1996) *Resource-based View of Strategic Alliance Formation: Strategic and Social Effects in Entrepreneurial Firms*, Organization Science, Vol. 7 No 2, pp. 136 – 150

Forsgren, M. and Johanson, J. (1994) *Managing Networks in International Business*, Gordon and Breach Science Publishers

Gomes-Casseres, B (1994) *Group Versus Group: How Alliance Networks Compete,* Harvard Business Review, Vol.72, N 4, Jul-Aug, pp.62-74

Gomes-Casseres, B. (1996) *The Alliance Revolution: The New Shape of Business Rivalry*, Cambridge, MA: Harvard University Press

Granovetter, M. (1985) *Economic action and social structure: The problem of embeddedness*, American Journal of Sociology, 91, pp. 481 – 510

Grant, R.M. (1991) *The Resource-Based Theory of Competitive Advantage: Implications for Strategy Formulation*, California Management Review (Spring), 33, (3), pp. 114 – 135

Gulati, R. (1995) *Does familiarity breed trust? The implication of repeated ties for contractual choice in alliances*, Academy of Management Journal, 38, pp. 85-112

Hagedoorn, J. (2002) *Inter-Firm R&D Partnerships: An Overview Of Major Trends And Patterns Since 1960,* Research Policy, Vol. 31, Iss. 4, pp. 477 – 492

Hagedoorn, J., (1996) *Trends and Patterns in Strategic Technology Partnering Since the Early Seventies*, Review of Industrial Organization, 11, pp. 601 – 616

Hakansson, H. (1989) *Industrial Technological Development: A Network Approach,* Routledge

Hakansson, H. (1992) *Corporate Technological Behaviour. Co-operation and Networks,* Routledge

Hamel, G. (1991) *Competition for Competence and International Partner Learning within International Strategic Alliances*, Strategic Management Journal, Vol. 12, pp. 83 – 103

Hamel, G., Doz, Y. and Parahalad, C. (1989) *Collaborate With Your Competitors and Win*, Harvard Business Review, January – February, pp. 133 – 139

Hannah, M. and Freeman, J., (1977) *The Population Ecology of Organizations*, American Journal of Sociology, Vol. 82 No 5, pp. 929-964

Hladik, K. (1985) *International Joint Ventures*, Lexington Books, Lexington, Massachusetts

Hodgson, G.M. (1998) *Competence and contract in the theory of the firm,* Journal of Economic Behaviour and Organization**,** 35, pp. 179–201

Inkpen, A.C. (1998) *Learning and knowledge acquisition through international strategic alliance,* Academy of Management Executive, 124, pp. 69–80

Jarillo, J. (1988) *On Strategic Networks*, Strategic Management Journal, Vol. 9, pp. 31 – 41

Jarillo, J. (1993) *Strategic Networks. Creating the Borderless Organization*, Oxford, Butterworth-Heinemann Ltd

Johanson, J. (1987) *Anarchists and Organizers: Entrepreneurs in a Network Perspective*, International Studies of Management and Organizations, Vol. 17(1), pp. 49 – 63

Johanson, J. and Vahlne, J.E. (1990) *The Mechanism of Internationalization,* International Marketing Review, Vol. 7, No 4, pp. 11 – 24

Katila, R. and Mang, P., (2003) *Exploiting technological opportunities: the timing of collaborations*, Research Policy, Vol. 32, Iss. 2, pp. 317-332

Kogut, B. (1988) *Joint ventures: theoretical and empirical perspectives*, Strategic Management Journal, 9, pp. 319–332

Kogut, B. and Zander, U. (1993) *Knowledge of the firm and the evolutionary theory of the multinational corporation*, Journal of International Business Studies, 24, pp. 625–645

Kolb, D.A. (1985) *Experiential Learning,* Pearson, Englewood Cliffs, NJ

Link, A., Bauer, L. (1989) *Cooperative research in US manufacturing,* Lexington Books, Lexington, MA

Linnarsson,H. and Werr, A. (2004) *Overcoming the innovation-alliance paradox: a case study of an explorative alliance*, European Journal of Innovation Management, Vol. 7, N 1, pp. 45-55

Lippman, S A. and Rumelt. R. P. (1982) *Uncertain imitability: An analysis of interfirm differences in efficiency under competition*, Bell Journal of Economics, 13, pp. 418-438

Marshall, C. (2004) *The dynamic nature of innovation partnering: a longitudinal study of collaborative interorganizational relationships*, European Journal of Innovation Management, Vol. 7, N 2, pp. 128-140

Maylor, H. and Blackmon, K. (2005) *Researching Business and Management*, Palgrave Macmillan, New York

Miles, R.E. and Snow, C.C. (1984) *Fit, failure and the hall of fame*, California Management Review, XXVI, pp. 10–18

Miotti, L. and Sachwald, F. (2003) *Co-operative R&D: why and with whom? An integrated framework of analysis,* Research Policy, Vol. 32, Iss. 8, pp. 1481-1499 Mitchell, J.C. (1983) *Case and situation analysis*, Sociological Review, 31, pp. 186-211

Oppenheim, A.N. (1994) *Questionnaire Design, Interviewing and Attitude Measurement*, Pinter Publishers Ltd

Pennings, J. and Puranam, P., (2000) *Market Convergence & Firm Strategies: Towards a systematic analysis,* Paper presented at the Organization Science Winter Conference, Keystone, CO, USA

Penrose, E. (1959) *The Theory of the Growth of the Firm*, Wiley, New York

Peteraf, M.A. (1993) *The cornerstones of competitive advantage: a resource-based view*, Strategic Management Journal, 14, pp. 179–191

Pfeffer, J. and Salancik, G. (1978) *The External Control of Organizations: A resource dependence perspective*, Pearson Education, NJ

Prahalad, C.K. and Hamel, G. (1990) *Core Competence of the Corporation*, Harvard Business Review, 3, pp. 79 – 91

Rumelt, R. (1984) *Towards a strategic theory of the firm*, in Lamb, R. (Ed.), *Competitive Strategic Management*, Prentice-Hall, Englewood Cliffs, pp. 556–570

Rumelt, R. P. (1974) *Strategy, Structure and Economic Performance*, Harvard University Press

Schumpeter, J.A. (1942) *Capitalism, socialism and democracy,* Harper & Row, NY

Seabright, M. A., Levinthal. D. A. and Fichman, M. (1992) *Role of individual attachments in the dissolution of interorganizational relationships*, Academy of Management Journal, 35, pp. 122-160

Teece, D. (1992) *Competition, cooperation, and innovation*, Journal of Economic Behavior and Organization, 18, pp. 1–25

Teece, D. and Pisano, G. (1994) *The dynamic capabilities of the firms: an introduction*, Industrial and Corporate Change, 3, pp. 537–556

Teece, D.J., Pisano, G. and Shuen, A., (1997) *Dynamic capabilities and strategic management*, Strategic Management Journal, 18(7), pp. 509-533

Vanhaverbeke, W. and Noorderhaven, N.G. (2001) *Competition between Alliance Blocks: The Case of the RISC Microprocessor Technology*, Organization Studies, Vol. 22, Iss.1, pp.1

Wang, J.C. (1994) *Cooperative research in a newly industrialized country: Taiwan,* Research Policy, 23, pp. 697–711

Warren, R.L. (1967) *The Interorganizational Field as a Focus for Investigation*, Administrative Science Quarterly, 12, pp. 396 – 419

Weidenbaum, M. and Hughes, S. (1996) *The Bamboo Network: How Expatriate Chinese Entrepreneurs Are Creating a New Economic Superpower in Asia,* The Free Press, New York

Williamson, O. (1975) *Markets and Hierarchies: Analysis and Antitrust Implications*, New York, The Free Press

Williamson, O. (1985) *The Economic Institutions of Capitalism*, New York, Free Press

Wilson, D. (1987) *The Effects of Organizational Structures and Technology Transfer as Strategic Alliance Success*, Sloan School of Economics, Massachusetts Institute of Technology

# ORGANIZATIONAL AMBIDEXTERITY: AN EMPIRICAL EXAMINATION OF ORGANIZATIONAL FACTORS AS ANTECEDENTS OF

# ORGANIZATIONAL AMBIDEXTERITY

**Şükrü AKDOĞAN**
**Nevşehir University, Turkey**
**A. Asuman AKDOĞAN**
**Erciyes University, Turkey**
**Ayşe CİNGÖZ**
**Nevşehir University, Turkey**

## ABSTRACT

*Ambidexterity broadly refers to an organization's ability to pursue two disparate things at the same time. Ambidextrous firms are capable of exploiting existing competencies as well as exploring new opportunities with equal dexterity. Capacity to pursue both exploitative and exploratory orientation depends on combinations of contradictory organizational characteristics such as decentralization, formalization, and connectedness. This study aims to explain organizational ambidexterity and organizational factors that are antecedents of ambidexterity in a theoretical way and to examine the impacts of these factors on organizational ambidexterity empirically. Data was obtained from private corporations operating in Kayseri (Turkey). Regression analysis was used to examine the relationship between organizational ambidexterity and contradictory organizational characteristics, and to test the research hypothesis. The results of regression analysis provide support for hypothesis.*

**Key Words:** Organizational Ambidexterity, Exploitation, Exploration, Contradictory Organizational Characteristics

## INTRODUCTION

The changes in technological, economic, legal, natural, social and cultural conditions and the failure of the organizations to accommodate the new conditions increase the gap between the organization and its environment. The mechanical organizational structure, the lack of external environmental support and environmental analysis and ignoring the signals of change lead to crisis by increasing strategic gap. Crisis is an event that is unpredictable, threatening important values and creating pressure for a timely response (Glasscock, 2004. 33). Crisis distorts the routine system and it threatens the survival of organizations as well as the ongoing activities. Considering these impacts, crisis requires a rapid response. The inefficiency of the organization in information gathering and decision making during the crisis situation decreases the chances of success against the crisis. There are a variety of strategic choices, which can be utilized in crisis prevention or minimizing the losses during the crises. One of these alternatives is "organizational ambidexterity".

Ambidexterity broadly refers to an organization's ability to pursue two disparate things at the same time (Gibson and Birkinshaw, 2004: 210; Lin et al., 2007: 1646). Ambidextrous firms are capable of exploiting existing competencies as well as exploring new opportunities with equal dexterity (Lubatkin et al., 2006: 647). Adapting to changing environmental conditions and obtaining sustainable competitive advantage broadly depend on both exploiting current resources and exploring new opportunities in order to make an innovation. Finland's Nokia Corp could be a good example in order to illustrate more concretely how firms can do this; It has been trying out a vast array of new mobile technology offerings, while continuing to invest in its dominant handsets franchise (Birkinshaw and Gibson, 2004a: 47).

Applying organizational ambidexterity strategy enables cost-effectiveness for a firm and helps firms to meet different customers' needs. In addition, ambidexterity is very important for organizational survival and success. Previous studies indicate that many successful firms are ambidextrous. If a firm wants to gain these advantages and wants to be ambidextrous, some organizational antecedents and external environmental factors should support this strategy. External environmental factors that effect ambidexterity are environmental dynamism and competitiveness (Jansen et al., 2005: 352; O'Reilly and Tushman, 2007: 20). In addition to environmental factors, organizational antecedents that can be seen as a determinant of organizational ambidexterity are the combinations of contradictory organizational characteristics such as decentralization, formalization, and connectedness (Jansen et al., 2005: 352).

Organizational ambidexterity is a new concept in Turkish literature. An empirical examination towards explaining the antecedents of organizational ambidexterity has not been done yet. Therefore, this study will become very useful to fill in this gap. Also, this study guides organizations' managers who work under uncertainty and crisis conditions about how to apply organizational ambidexterity and how to arrange organizational structure to achieve this strategy. Our objective in this study is to explain organizational ambidexterity and organizational factors that are antecedents of ambidexterity in a theoretical way and to empirically examine the impacts of these factors on organizational ambidexterity. In this context, we first explain organizational ambidexterity theoretically. Then, we address the antecedents of the ambidexterity. Finally we test our hypothesis by presenting and discussing our empirical findings.

## THEORETICAL BACKROUND AND HYPOTHESIS

Organization theorists have recently adopted the human trait of ambidexterity, or the ability of individuals to use both their hands with equal skill, as a metaphor to describe organizations (Lubatkin et al., 2006: 647). Traditionally, in organizational literature ambidexterity broadly refers to an organization's ability to pursue two disparate things at the same time-such as manufacturing efficiency and flexibility, standardization and innovation, differentiation and low-cost strategic positioning, or global integration and local responsiveness (Gibson and Birkinshaw, 2004: 210; Lin et al., 2007: 1646; Han and Celly, 2008: 335). One of good examples which had this ability is Seiko. In the mid-1960s, Seiko transformed itself from being merely a mechanical watch firm into being both a quartz and mechanical watch company. This move into low-cost, high-quality watches triggered wholesale change within Seiko and, in turn, within the world-wide watch industry (Tushman and O'Reilly, 1996: 10). This case shows that Seiko achieved both low-cost and high-quality strategic positioning in the watch industry at the same time.

More specifically, the ambidextrous organization achieves alignment in its current operations while also adapting effectively to changing environmental demands (Gibson and Birkinshaw, 2004: 210; Jansen, 2005: 15; Raisch and Birkinshaw, 2008: 375). Tushman and O'Reilly defined ambidexterity as the "ability to simultaneously pursue both incremental and discontinuous innovation and change" (1996: 8). March and Simon (1958) discussed the balance between the conflicting demands for exploitation and exploration (March, 1991: 71; Benner and Tushman, 2003: 238, Gibson and Birkinshaw, 2004: 210).

Also, ambidexterity can be undertaken in two different forms as structural ambidexterity and contextual ambidexterity (Birkinshaw and Gibson, 2004a: 49; Birkinshaw and Gibson, 2004b: 3-4; Gibson and Birkinshaw, 2004: 209). Contextual ambidexterity that is achieved within a single organizational unit is the behavioral capacity to simultaneously demonstrate alignment and adaptability across an entire business unit (Gibson and Birkinshaw, 2004: 210, Kauppila, 2007: 3; Filiou and Windrum, 2008: 1). Alignment refers to coherence among all the patterns of activities in the business unit; they are working together toward the same goals. Adaptability refers to the capacity to reconfigure activities in the business unit quickly to meet changing demands in the task environment. Contextual ambidexterity can be viewed as a meta-level capacity that permeates all functions and levels in a unit, rather than as a "dual structure" in which the two demands are kept separate.

Structural ambidexterity is to create separate structures for different types of activities. For example, the core business units are given responsibility for creating alignment with the existing products and markets; and the R&D department and business development group are given the job of prospecting for new markets, developing new technologies and keeping track of emerging industry trends (Birkinshaw and Gibson, 2004a: 49). As can be seen below, structural ambidexterity emphasizes the importance of simultaneously balancing contradictory tensions in an organization.

The concept of contextual ambidexterity differs from structural ambidexterity in many important ways. These differences are shown in Table 1.

**Table 1**
**Differences Between Contextual Ambidexterity and Structural Ambidexterity**

| | Structural Ambidexterity | Contextual Ambidexterity |
|---|---|---|
| **How is ambidexterity achieved?** | Alignment-focused and adaptability-focused activities are done in separate units or teams | Individual employees divide their time between alignment-focused and adaptability-focused activities |
| **Where are decisions made about the split between alignment and adaptability?** | At the top of the organization | On the front line-by salespeople, plant supervisor, office worker |
| **Role of top management** | To define the structure, to make trade-offs between alignment and adaptability | To develop the organizational context in which individuals act |
| **Nature of roles** | Relatively clearly defined | Relatively flexible |
| **Skills of employees** | More specialists | More generalist |

Birkinshaw, J. and Gibson, C. (2004a), Building Ambidexterity into an Organization, MIT Sloan Management Review, 45, p. 50.

Table 1 demonstrates that, structural ambidexterity is achieved by doing alignment-focused and adaptability-focused activities in separate units or teams. However, contextual ambidexterity is achieved through individual employees who divide their time between alignment-focused and adaptability-focused activities. Despite these differences, two approaches should be viewed as complementary. In fact, many successful companies, including Hewlett-Packard, 3M and Intel, use a combination of both approaches to deliver simultaneously on the needs for alignment and adaptability (Birkinshaw and Gibson, 2004a: 50).

Organizational ambidexterity requires firms to address exploitation and exploration (Raisch and Birkinshaw, 2008: 389). Ambidextrous firms are capable of exploiting existing competencies as well as exploring new opportunities with equal dexterity (Lubatkin et al., 2006: 647). Exploitation includes such things as refinement, choice, production, efficiency, selection, implementation, execution (March, 1991: 71, He and Wong, 2004: 481; Lin et al., 2007: 1645). The intent of exploitation is to respond to current environmental conditions by adapting existing technologies and further meeting the needs of existing customers (Lubatkin et al., 2006: 647). In contrast, exploration includes things such as search, variation, risk taking, experimentation, flexibility, discovery, innovation (March, 1991: 71; He and Wong, 2004: 481). Developing new technological or marketing methods are very important for exploration. Exploration is intended to respond to, as well as drive, latent environmental trends by creating innovative technologies and new markets (Lubatkin et al., 2006: 647). Exploration and exploitation require substantially different structures, processes, strategies, capabilities and cultures to pursue and may have different impacts on firm adaptation and performance. In general, exploration is associated with organic structure, loosely coupled systems, improvisation, autonomy and chaos. Exploitation is associated with mechanistic structure, tightly coupled systems, routinization, control and bureaucracy (He and Wong, 2004: 481). Certain differences between exploitation and exploration concepts are indicated in Table 2.

**Table 2**
**Comparison of Exploitation and Exploration**

| | Exploration | Exploitation |
|---|---|---|
| **Outcomes** | New designs, new markets, and new distribution channels | Existing designs, current markets, and existing distribution channels |
| **Knowledge base** | Require new knowledge and departure from existing knowledge | Build and broaden existing knowledge and skills |
| **Result from** | Search, variation, flexibility, experimentation, and risk-taking | Refinement, production, efficiency, and execution |
| **Performance implications** | Distant in time | Short-term benefit |

Jansen, J. (2005), Ambidextrous Organizations: A Multiple-Level Study of Absorptive Capacity, Exploratory and Exploitative Innovation and Performance, Unpublished Dissertation, p. 19.

Exploitation and exploration activities are not new, however, rarely has past research perceived exploitation and exploration activities as two edge of one continuum (Oshri et al., 2005: 10). As competition intensifies and the speed of change arises, firms are increasingly confronted with a tension between exploiting existing competencies and exploring new ones (Jansen et al., 2005: 351). Adaptation to existing environmental demands may foster structural inertia and reduce firms' capacity to adapt to future environmental changes and new opportunities. On the other hand, experimenting with new alternatives reduce the speed at which existing competencies are improved and refined (March, 1991: 71; He and Wong, 2004: 482). As a result, achieving a proper balance between exploration and exploitation may be the primary factor for sustainable prosperity.

Organizational ambidexterity that is capable of exploiting existing competencies as well as exploring new opportunities with equal dexterity is very crucial to organizational survival. Previous studies also argue that successful firms are ambidextrous (Jansen, 2005: 15; Jansen et al., 2005: 352). That is, they can: (a) avoid major or sudden organizational changes, (b) achieve higher performance and sustainability, (c) divert organizational inertia, (d) obtain higher sales growth, (e) improve their learning capacity, (f) make a profit through both revolutionary and evolutionary change, change and preservation or exploratory and exploitative innovations (Tushman and O'Reilly, 1996: 24; Gibson and Birkinshaw, 2004: 210; O'Reilly and Tushman, 2007: 29; Han and Celly, 2008: 336). Although, a positive interaction between exploration and exploitation i.e., organizational ambidexterity provides these benefits to firms, in practice; because of exploration and exploitation need fundamentally different logic, a limited number of firms are succeeded at managing ambidexterity. Therefore, certain conditions and organizational characteristics are necessary to apply such a strategy, successfully. Especially, it needs a special style of managers or leaders.

Furthermore, there is little empirical research has been made about what factors have impact on organizational ambidexterity. For a firm, to be ambidextrous both organizational antecedents and external environmental factors must support this strategy. External environment factors that effect ambidexterity are environmental dynamism and competitiveness. Organizations that operate in dynamically competitive environments simultaneously pursue both exploratory and exploitative innovations (Jansen et al., 2005: 352; O'Reilly and Tushman, 2007: 30). In addition to environmental factors, a decentralized structure, a common culture and vision, a clear consensus within the senior team about the strategy and the importance of ambidexterity, tight coordination, top management integration, supportive leaders and flexible managers are needed as the key sources of ambidexterity (Tushman and O'Reilly 1996: 26-27; Gibson and Birkinshaw, 2004: 212; Kauppila, 2007: 10; O'Reilly and Tushman, 2007: 24; Raisch and Birkinshaw, 2008: 389). Barlett and Ghoshal (1989) also focused on building a shared vision, recruitment and selection, training and career path management of executives as way of stimulating a company to be globally integrated and locally responsive at the same time (Gibson and Birkinshaw, 2004: 212). Besides these factors, capacity to pursue both an exploitative and exploratory orientation depends on combinations of contradictory organizational characteristics such as decentralization, formalization, and connectedness (Jansen et al., 2005: 352).

Formalization represents the degree to which rules define roles, authority relations, communications, norms and sanctions, and procedures (Deshpande and Zaltman, 1982: 18; Jaworski and Kohli, 1993: 56). Formalization is aimed at reducing variance through incremental improvements in processes and outputs. Through formalization, organizations codify best practices so as to make them more efficient to exploit and accelerate its diffusion (Jansen et al., 2005: 354). In the literature, it was argued that bureaucracies do well in the implementation of innovations but poorly in the generation of innovations (Adler and Borys, 1996: 63). That is, formalization enhances exploitative innovations through improvement of current products, services, and processes. It motivates individuals to share explicit as well as tacit knowledge, and it reduces the cost associated with knowledge sharing (Jansen et al., 2005: 354). Briefly, formalization is concerned with an organization's responsiveness and information utilization. So, formal organizational structure and systems are proper to apply exploitative strategy.

Hage and Aiken (1967: 510) described decentralization as organizational members' participation to the organizational decisions. Decentralization allows for the interplay between a variety of perspectives and leads to a rich internal network of diverse knowledge resources (Hage and Aiken, 1967: 510; Jansen et al., 2005: 354). Decentralization facilitates ad hoc problem solving that increase the range of possible responses to problems and supports exploratory learning. From this point of view, amount of the delegation of decision-making authority throughout an organization and the extent of participation by organizational members in decision-making is appropriate for exploratory orientation.

Connectedness refers to the degree of formal and informal direct contact among employees in organization (Jaworski and Kohli, 1993: 56). Densely connected networks permit individuals to develop deep knowledge structure, to exchange information and to refine existing businesses, products, and processes (Jaworski and Kohli, 1993: 56; Jansen et al., 2005: 354).

In this respect, combining the required organizational characteristics is an important issue in order to pursue both exploitative and exploratory orientation simultaneously. Decentralization of decision-making supports an organization's exploratory innovations, but without formal and densely connected structures these new opportunities may not be exploited successfully (Jansen et al., 2005: 354). Therefore, interactions of these factors that act complementarily and reinforce each other are necessary to achieve ambidexterity. Accordingly, we propose that ambidextrous organizations combine contradictory organizational characteristics such as decentralization, formalization, and connectedness. In this context, we suggest the following hypothesis.

**Hypothesis:** Interaction of decentralization, formalization, and connectedness has positive impact on organizational ambidexterity.

### METHOD, RESULTS AND DISCUSSION

## Sample and Measurement

Data is obtained from one of the top executives of each 83 private companies in Kayseri, Turkey, and structured questionnaire forms were used. The sample was sufficient to allow statistical analysis at the corporate level (Gibson and Birkinshaw, 2004: 212). We examined ambidexterity with dimensions of exploitation and exploration. Ambidexterity was assessed using the 12-item scale measure and 5-point scale ranging from 1 (strongly disagree) to 5 (strongly agree) that was developed by Lubatkin et al. (2006). In addition, contradictory organizational characteristics that consist of decentralization, formalization, and connectedness were measured by scales that were developed by Tanenbaum and Schmidt (1973), Aiken and Hage (1968) and, Jaworski and Kohli (1993) in turns. These measures were assessed with 5-point Likert scales ranging from 1-strongly disagree to 5-strongly agree. Regression analysis was used to examine the relationship between organizational ambidexterity and contradictory organizational characteristics.

## Analysis and Test of the Hypothesis

Cronbach's alpha scores for each variable exceeded 0.70 (organizational ambidexterity ($\alpha$=0.820), formalization ($\alpha$=0.776), decentralization ($\alpha$=0.737), and connectedness ($\alpha$=0.712)), which is an acceptable level of reliability.

**TABLE 3[a]**
**Descriptive Statistics and Correlations**

| Variables[b] | Mean | s.d. | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|---|---|
| 1. Ambidexterity | 16.33 | 6.888 | | | | | | |
| 2. Exploitation | 3.96 | 0.638 | .688** | | | | | |
| 3. Exploration | 4.02 | 1.275 | .962** | .498** | | | | |
| 4. Contradictory Organizational Characteristics | 41.99 | 16.808 | .353** | .511** | .246* | | | |
| 5. Decentralization | 3.37 | 0.665 | .324** | .401** | .252* | .798** | | |
| 6. Formalization | 3.23 | 0.508 | .339** | .421** | .251* | .757** | .406** | |
| 7. Connectedness | 3.71 | 0.627 | .189 | .406** | .103 | .764** | .414** | .460** |

[a]n= 83 (organizations)
[b]Ambidexterity is the multiplicative interaction of exploitation and exploration. Contradictory organizational characteristics are the multiplicative interaction of decentralization, formalization, and connectedness.
*$p$ <.05
**$p$ <.01

Means, standard deviations, and correlations among the variables are presented in Table 3. According to our analysis, all of the other research variables are positively and significantly correlated with each other except connectedness. Connectedness doesn't have significant correlation with organizational ambidexterity and exploration. In the literature, it is argued that, densely connected networks permit individuals to develop deep knowledge structure, to exchange information and to refine existing businesses, products, and processes (Jaworski and Kohli, 1993: 56; Jansen et al., 2005: 354). That is, connectedness may enhance both exploitative and exploratory orientation. However, in this research it is only correlated with exploitation. Notwithstanding, there are positive and significant relations among connectedness and other variables.

There is a positive and significant correlation between exploitation and exploration. This indicates that organizations can achieve both simultaneously. There is a very strongly and positively correlation among dimensions of ambidexterity and ambidexterity, and also among dimensions of contradictory organizational characteristics. These findings support results of previous studies (Gibson, and Birkinshaw, 2004; Jansen et al., 2005). Further, decentralization, formalization, and their interaction (contradictory organizational characteristics) are significantly and positively related to exploitation, exploration and their interaction (ambidexterity). For example, formalization is positively and significantly correlated with exploitative (.421). Formalization enhances exploitative innovations through improvement of current products, services, and processes. According to the results of descriptive analysis, 59 percent of managers believed that people who work in their organizations feel as though they are constantly being watched to see that they obey all the rules. 69.9 percent of managers stated that, the employees are constantly being checked on for rule violations. Level of formalization can be seen as high (3.23) in these organizations, which participated in the research. Also, decentralization facilitates ad hoc problem solving that increase the range of possible responses to problems and supports exploratory learning. From this point of view, amount of the delegation of decision-making authority throughout an organization and the extent of participation by organizational members in decision-making are appropriate for exploratory orientation. The result shows that mean score for decentralization is 3.37. This result implies that there is high level decentralization in our sample.

Nonetheless, decentralization of decision-making supports an organization's exploratory innovations, but without formalization these new opportunities may not be exploited successfully. Therefore, interactions of these factors that act complementarily and reinforce each other are necessary to achieve ambidexterity. That is, contradictory organizational characteristics are essential to pursue both exploitation and exploration with equal dexterity. Similarly, our results show that there is a positive correlation between ambidexterity and contradictory organizational characteristics. Therefore, the more interaction of decentralization, formalization, and connectedness increases, the more organizational ambidexterity increases.

Regression analysis was used to examine the relationship between organizational ambidexterity and contradictory organizational characteristics. Regression analysis results are presented in Table 4.

**TABLE 4**
**Results of Regression Analysis**

| **Independent Variables** | **Dependent Variable: Organizational Ambidexterity** | |
|---|---|---|
| | **$R^2$** | **Adjusted $R^2$** |
| 1. Decentralization | .105 | .094 |
| 2. Formalization | .115** | .104 |
| 3. Connectedness | .036* | .024 |
| 4. Decentralization*Formalization*Connectedness | .124*** | .114 |
| 5. Decentralization*Formalization | .153*** | .143 |
| 6. Decentralization*Connectedness | .093* | .082 |
| 7. Formalization*Connectedness | .091* | .080 |

*$p$ <.05
**$p$ <.01
***$p$ <.001

According to the results of regression analysis, the relationship between the contradictory organizational characteristics (independent variable) and organizational ambidexterity (dependent variable) is statistically significant ($R^2$= .124). Contradictory organizational characteristics can explain the changes on organizational ambidexterity on 12.4%. Therefore, research hypothesis indicating "Interaction of decentralization, formalization, and connectedness has positive impact on organizational ambidexterity" is supported. That is, interaction of decentralization, formalization, and connectedness has positive and significant effects on organizational ambidexterity. In this context, our study provides empirical support for the argument that organizations are able to increase level of ambidexterity by combining contradictory organizational characteristics.

When other variables are examined, formalization and connectedness are found to significantly effect on ambidexterity, but decentralization is not. Furthermore, interaction between decentralization and formalization positively influences an organization to pursue exploratory and exploitative simultaneously ($R^2$= .153). These findings contribute to recent research proposing that organizations become more ambidextrous by combining contradictory elements (Adler and Borsy, 1996; Gibson, and Birkinshaw, 2004; Jansen et al., 2005). Also, interaction of formalization and connectedness affects organizational ambidexterity in a positive way. However, this interaction has low impact on ambidexterity. A primary reason for this result could be that densely connected social relations establish strong norms and beliefs that diminish the likelihood of conflict over goals and implications and encourage compliance with rules. Therefore, connectedness reduces the need for formal controls and decreases the useless of formalization (Jansen et al., 2005: 359).

# CONCLUSION

Organizational ambidexterity is the ability of exploiting existing competencies as well as exploring new opportunities with equal dexterity. One of the main factors that can help organizations to be ambidextrous is interaction of contradictory organizational characteristics. These characteristics are decentralization, formalization, and connectedness. Formal organizational structure and systems are required to apply exploitative strategy. Decentralization facilitates ad hoc problem solving that increase the range of possible responses to problems and supports exploratory learning. Connectedness may enhance both exploitative and exploratory orientation. However, decentralization of decision-making supports an organization's exploratory innovations, but without formal and densely connected structures these new opportunities may not be exploited successfully. Therefore, interactions of these factors that act complementarily and reinforce each other are necessary to achieve ambidexterity. In this context, we examined organizational ambidexterity and organizational factors that are antecedents of ambidexterity in a theoretical way and researched the impacts of these factors on organizational ambidexterity empirically.

The results of our analysis show that contradictory organizational characteristics are significantly and positively related to exploitation, exploration and their interaction (ambidexterity). The more interaction of decentralization, formalization, and connectedness increases, the more organizational ambidexterity increases. In this respect, our study provides empirical support for the argument that organizations are able to increase level of ambidexterity by combining contradictory organizational characteristics.

Results of this research are restricted with the sample. More different findings could be obtained from broader samples. Future research may examine how environmental factors affect organizational ambidexterity and may investigate the relation between organizational ambidexterity and organizational performance.

## REFERENCES

Aiken, M. and Hage, J. (1968), Organizational Independence and Intra-organizational Structure, *American Sociological Review,* 33, pp. 912-30.

Adler, P. S. and Borys, B. (1996), Two Types of Bureaucracy: Enabling and Coercive, *Administrative Science Quarterly,* 41(1), pp. 61-89.

Benner, M. J. and Tushman, M. L. (2003), Exploitation, Exploration, and Process Management: The Productivity Dilemma Revisited, *Academy of Management Review*, 28, pp. 238-256.

Birkinshaw, J. and Gibson, C. (2004a), Building Ambidexterity into an Organization, *MIT Sloan Management Review,* 45, pp. 46-55.

Birkinshaw, J. and Gibson, C. (2004b), Building an Ambidextrous Organization, *Aim Research Working Paper Series,* 003, pp. 1-18.

Deshpande, R. and Zaltmen, G. (1986), Factors Affecting the Use of Market Research Information: A Path Analysis, *JRM, Journal of Marketing Research,* 19, pp. 14-31.

Filiou, D. and Windrum, P. (2008), Inter-Firm Ambidexterity in Complementary Competence Domain: A Study of UK Biotech, *Academy of Management Proceedings,* pp. 1-6.

Gibson, C. B. and Birkinshaw, J. (2004), The Antecedents, Consequences, and Mediating Role of Organizational Ambidexterity, *Academy of Management Journal*, 47, pp. 209-226.

Glasscock, J. (2004), The Jasper Dragging Death: Crisis Communication and The Community Newspaper, *Communication Studies,* 55, pp. 29-47.

Han, M. and Celly, N. (2008), Strategic Ambidexterity and Performance in International New Ventures, *Canadian Journal of Administrative Sciences,* 25, pp. 335-349.

He, Z. L. and Wong, P. K. (2004), Exploration vs. Exploitation: An Empirical Test of the Ambidexterity Hypothesis, *Organization Science,* 15, pp. 481-494.

Jansen, J. (2005), Ambidextrous Organizations: A Multiple-Level Study of Absorptive Capacity, Exploratory and Exploitative Innovation and Performance, *Unpublished Dissertation,* ERIM https://ep.eur.nl/handle/1765/6774 .

Jansen, J. J. P., Van den Bosch, F. A. J. and Volberda, H. W. (2005), Exploratory Innovation, Exploitative Innovation, and Ambidexterity: The Impact of Environmental and Organizational Antecedents*, Schmalenbach Business Review,* 57, pp. 351-363.

Jaworski, B. J. and Kohli, A. K. (1993), Market Orientation: Antecedents and Consequences, *Journal of Marketing*, 57, pp. 53-70.

Kauppila, O. P. (2007), Towards A Network Model of Ambidexterity, *Helsinki School Economics Working Papers,* W-429, pp. 1-39.

Lin, Z., Yang, H. And Demirkan, I. (2007), The Performance Consequences of Ambidexterity in Strategic Alliance Formations: Empirical Investigation and Computational Theorizing, *Management Science*, 53, pp. 1645-1658.

Lubatkin, M. H., Şimşek, Z., Ling, Y. and Veiga, J. F. (2006), Ambidexterity and Performance in Small- to Medium-Sized Firms: The Pivotal Role of Top Management Team Behavioral Integration, *Journal of Management*, 32, pp. 646-672.

March, G. James, (1991), Exploration and Exploitation in Organizational Learning, *Organization Science,* 2, pp. 71-87.

O'Reilly, C. A. and Tushman, M. L. (2007), Ambidexterity as a Dynamic Capability: Resolving the Innovator's Dilemma, *Working Papers,* 07-088, pp. 1-61.

Oshri, I., Pan, L. S. and Newell, S. (2005, Trade-offs Between Knowledge Exploitation and Exploration Activities, Knowledge *Management Research & Practice,* 3, pp. 10-23.

Raisch, S. and Birkinshaw, J. (2008), Organizational Ambidexterity: Antecedents, Outcomes, and Moderators, *Journal of Management,* 34, pp. 375-409.

Tanenbaum, R. and Schmidt, M. (1973), Hoe to Choose A Leadership Pattern, *Harvard Business Review,* May/June, pp. 162-180.

Tushman, M. L. and O'Reilly, C. A. (1996), Ambidextrous Organizations: Managing Evolutionary and Revolutionary Change, *California Management Review*, 38, pp. 8-30.

# AMBIDEXTERITY: THE COMBINATION OF SEEMINGLY CONFLICTING PRIORITIES

**Lutfihak Alpkan and Selim Aren**
**Gebze Institute of Technology**

## ABSTRACT

*Duality of strategic purpose and the need for reconciling the seemingly contradictory strategic alternatives i.e. exploration and exploitation, create a severe challenge for both planning and implementation phases. The organizational ability to deal with this duality effectively and efficiently is labeled as "organizational ambidexterity". In this study, we develop some propositions that elaborate on the drivers, facilitators, and consequences of this new concept; and provide managerial and further research implications.*

## 1. INTRODUCTION

Increasing openness and vulnerability to the competitive challenges caused by the accelerating competition in the globalized world enforce the organized entities to develop sustainable competitive superiority in order to survive global crises providing both opportunities and threats at the same time. One of the most critical challenges for the strategists on the country, company, and even individual level is the ability to craft those strategies and structures that create and sustain competitive advantage in the long-run. The choice of strategy is related, on one hand, to the opportunities and threats present in the external environment according to the industrial organization model (e.g. Porter, 1980), and on the other, to the competencies, strengths and weaknesses present in the internal environment according to the resource based view (e.g. Barney, 1991).

The priority given specifically to any one of these two alternative strategic approaches constitutes the limits and trade offs of the strategies, tactics and organizational structures that can be chosen. For instance, if an organization chooses to concentrate on the external opportunities, this organization should try to build its superiority especially on the ability of external adaptation. As for the internal strengths, the organization should try to develop the ability of integral integration and synergy. In the short-run, it seems so difficult to try to develop both abilities simultaneously, which necessitate sacrificing of one for the other. However, in the long-run, competitive advantage can be sustained only if both abilities are tried to be developed in a balanced way.

Combination of seemingly conflicting priorities in this concern is conceptualized as the organizational ambidexterity. Defined originally as an individual skill of controlling both hemispheres of the brain leading to the ability of using one's left and right hands with nearly equal competence, ambidexterity is also adopted by the management literature as an organizational ability to concentrate on two conflicting priorities simultaneously. These two priorities can be labeled as exploration for external adaptation and exploitation for internal integration. Choosing only one of them, according to the external and internal dynamics, limits the tactics, operations, structures and expected returns in the implementation phase. Accordingly we can define organizational ambidexterity as a distinctive organizational ability of combining two organizational competencies or priorities which seem in general to be at the expense of the other, with the aim of creating a synergy of utilizing all the slack resources of the organization at the same time without causing any degradation of performance.

This study is a brief literature review on the concept of organizational ambidexterity discussing its antecedents and consequences and providing some propositions to be tested as hypotheses in further empirical researches. This introductory section precedes the second section on the theoretical framework. The third section discusses the proposed model and relations. The final section offers some managerial and further research implications.

# 2. THEORETICAL FRAMEWORK

The art of strategy making, which represents the mental efforts of crafting a long term hierarchy of organizational goals at country, corporate, business, divisional, departmental, and individual levels tied to each other with foreseen cause and effect relations, is the real source of superiority in the competition only if it is based on an intelligent calculation of priorities allocated among the goals at the same levels. Trade offs or dualities come to surface while making strategic choices among alternatives related to strategies (e.g. explore vs. exploit (Duncan, 1976, March, 1991), longterm growth vs short term profitibality, focus on cost or quality, variance reducing centralized strategy making vs. variance increasing autonomus strategy making (Burgelman 1991, Burgelman and Grove 2002), reactive vs proactive customer orientation (Narver, Slater and MacLachlan 2004), radical vs incremental innovation), and also to the structures (e.g. alignment vs. adaptability, mechanic vs organic organizations (Burns and Stalker, 1961), functional specialization and efficiency vs divisional decentralization and effectiveness).

The critical task of deciding about the priorities to be given to different strategies, i.e. focusing on some goals more than others and allocating resources accordingly, causes however the inefficient use of the slack resources and the inability to evaluate all the attractive opportunities. In this concern, duality inherited in the strategic goal setting process turns into a unity and synergy thanks to the concept of ambidexterity if balanced successfully; otherwise, it may cause further complications in the organization and execution processes. The main duality in the goal setting phase is the trade off between exploration and exploitation strategies; while the first one necessitates an organizational structure for adjustment and external adaptation, the second alternative mainly concentrates on alignment and internal integration. Firstly in this section, the advantages and disadvantages of focusing solely on any one of the strategic dualities are discussed. Then, the difficulties and benefits of ambidexterity as a unifying approach are mentioned.

## 2.1. Focusing on Exploration and Adjustment

According to Menguc and Auh (2008) exploration represents the organizational capability to learn through questioning, pushing the knowledge frontier, and challenging existing ideas by dealing with innovative and entrepreneurial concepts such as proactivity, risk taking, discovery, R&D, concept testing, and creative destruction (i.e. unlearning and destruction of established procedures and rules). Kyriakopoulos and Moorman (2004) define specifically marketing exploration as the extent to which the firm challenges and alters existing ideas about marketing strategies such as targeting, segmentation, product positioning, product differentiation, product distribution, product design, and so on. The necessary activities to increase the capability of exploration include such efforts to increase the rate of product, process and marketing innovations (Menguc and Auh, 2008). To engage successfully with these innovative, entrepreneurial and transformational activities, the organization should have an adhocracy culture and an organic structure with low centralization and formalization (Duncan, 1976). Exploration and adjustment enable firms to engage in experimentation, search, variation and radical innovation (Lin et al., 2007; March, 1991). However, excessive exploration at the expense of exploitation can drain resources and create a failure trap (Menguc and Auh, 2008).

## 2.2. Focusing on Exploitation and Alignment

According to Menguc and Auh (2008) exploitation represents the organizational capability to refine existing competencies and resources and to improve operational efficiency by concentrating on selection and implementation with a primary emphasis on control and conformance. The necessary activities to increase the capability of exploitation include such efforts to increase the level of economies of scale, modernization and automation of production processes, and capacity utilization (Menguc and Auh, 2008). To engage successfully with these transactional control activities, the organization should have a hierarchy culture and a mechanistic structure with high centralization and formalization (Duncan, 1976). Exploitation and alignment enable firms to engage in efficiency and refinement (Lin et al., 2007; March, 1991). However, excessive exploitation at the expense of exploration can create a myopic and inflexible mindset and generate a competency or success trap (Menguc and Auh, 2008).

## 2.3. Focusing on both: Ambidexterity

Ambidexterity defined as the combination or a set of two discrete capabilities, namely exploration versus exploitation (Menguc and Auh, 2008), alignment versus adaptability (Gibson and Birkinshaw, 2004), radical versus incremental innovation (Tushman and O'Reilly, 1996), or flexibility versus efficiency (Adler et al, 1999) is a rather new approach expected to combine the benefits of both possibilities.

Tushman and O'Reilly (1996) in their seminal work on ambidextrous organizations, suggest that managers and organizations must be able to implement both incremental and revolutionary change at the same time in order to avoid the syndrome or trap of success followed by failure and thus remain successful over longer periods. The key for success here according to them is ambidexterity, i.e. the art of balancing the efforts of alignment in the present or mature environment by the realization of efficiency and incremental innovation objectives, with the efforts of adjustment to the changing conditions by the realization of flexibility, speed and radical innovation objectives. Then, He and Wong (2004) find empirical support for this ambidexterity hypothesis.

It has however important difficulties to execute. According to Tushman and O'Reilly (1996) many companies which are large and wealthy enough to afford to exploit the present technologies and markets and to explore new ones may not yet be able to play these two games at the same time because of their internal conflict and inertia. It is very difficult in old and large firms to reshape the working atmosphere and managerial understandings of the top and middle managers and specialists and to build a consensus among them about the rationality of pursuing two seemingly alternative sets of capabilities and activities at the same time. The conservative proponents of one alternative may be resistant to reconcile both capabilities at the individual level (mental integration) and even at the business unit level (behavioral integration). For instance, on the one hand, proponents of exploration and adjustment may be resistant towards any attempts to increase discipline, hierarchy and bureaucracy; on the other hand, proponents of exploitation and alignment may be unwilling to face the tension and risks related to uncertainty, instability and change.

# 3. PROPOSED MODEL OF RELATIONS

Determining the antecedents and consequences of ambidexterity is very critical for the organizational performance in the long-run. Considering the above mentioned advantages and difficulties of ambidexterity, it can be argued that some internal and external factors facilitate the development of ambidextrous organizations with higher organizational performance.

## 3.1. Antecedents of Ambidexterity

Firm characteristics and strategic orientations that shape the suitable organizational milieu facilitate the implementation of strategic choices. Past literature emphasizes the firm size and age as important indicators of structural flexibility and adaptability. According to Tushman and O'Reilly (1996) younger and smaller organizations may be more able to avoid the trap of past performance and ready to face the internal conflict and inertia which can be managed more easily thanks to their more dynamic structure and culture. However, growth of a balanced organizational competence necessitates a large pool of resources and a long term experience based on trial and error which are not present in new and small firms. Thus beyond age and size, the real source of dynamism and flexibility is the corporate ability or tendency to tolerate risk taking, innovativeness and proactivity, i.e. entrepreneurial orientation. Beside corporate entrepreneurship, another source of ambidexterity may be the organizational climate of focusing both on market conditions and inner coordination, i.e. market orientation having the sub-dimensions of competitor and customer orientations and inter-functional coordination. Moreover, an organization according to Menguc and Auh (2008) should engage in exploratory learning while simultaneously bearing and reaping the fruits of a learning orientation.

*Proposition 1: the higher the entrepreneurial orientation the higher the organizational ambidexterity*

*Proposition 2: the higher the market orientation the higher the organizational ambidexterity*

*Proposition 3: the higher the learning orientation the higher the organizational ambidexterity*

## 3.2. Implementation of Ambidexterity

Past literature shows that ambidexterity can be implemented either by division of work or rotation in time (Raish and Birkinshaw, 2008). Division of work for ambidexterity means that different divisions, departments or individuals within the same organization may have complementary skills and tasks. For instance, while the R&D specialists focus on exploration for adjustment, production engineers may concentrate on exploitation for alignment at the same time. As for the rotation in time, different strategies and structures can be developed in different planning periods. According to Duncan (1973) and Johnston (1976) ambidexterity can be established by temporary fluctuations between periods of mechanic-routine and organic-adaptive structures/processes within the same work unit.

However, the pure version of ambidexterity necessitates a more holistic framework. In other words, by definition ambidexterity should be implemented at the same time by the same agents. In this concern, in order to be effective in external adaptation and efficient in the internal integration simultaneously within the same work unit, ambidexterity should become not only as an organizational or departmental ability but also that of the individuals within this organization. Thus, an ambidextrous organization needs ambidextrous human capital to make a successful implementation of the strategies. Human capital should be mentally ready and capable of dealing with two seemingly alternative sets of responsibilities driving from the combined objectives of alignment and adjustment at the same time. Human resource selection and training should be done accordingly. Therefore, high quality human power would amplify the performance impacts of ambidexterity.

*Proposition 4: the higher the quality of human capital the higher the performance impacts of organizational ambidexterity*

## 3.3. Consequences of Ambidexterity

Findings of recent empirical studies have already revealed that ambidexterity is an important driver of higher performance (e.g. He and Wong, 2004; Gibson and Birkinshaw, 2004; Auh and Mengüç, 2005; Mengüç and Auh, 2008). However, more specific cause and effect relations should be proposed and tested. Firstly, the empirical studies should make a comparison between the performance impacts of combining strategies i.e. ambidexterity and that of concentrating strategies solely on either exploration or exploitation. Then more specifically, beside overall organizational performance in terms of returns or sales growth, other performance indicators should be discussed. In this concern, operational performance indicators may be tied to exploration, exploitation or both. For instance, while exploration may lead to an increase in the innovative performance, speed of delivery, and flexibility; exploitation may contribute to increased quality and decreased cost; but when combined strategies are applied all the performance indicators would be better.

*Proposition 5: the performance impact of organizational ambidexterity is higher than that of only exploration or exploitation*

The above mentioned propositions lead us to develop a model of relations depicted in Figure 1.

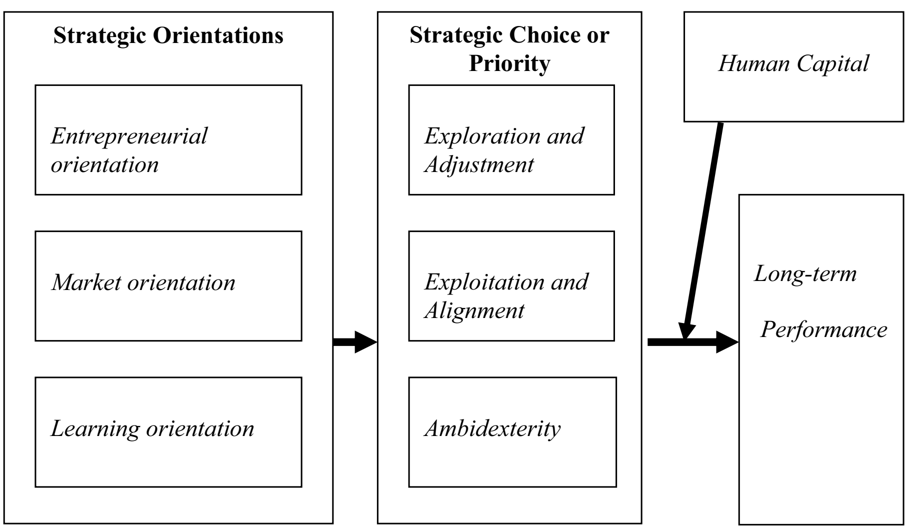



Figure 1. The proposed Model of Relations

# 4. RESULTS AND CONCLUSION

Strategic orientations are proposed in this study as the antecedents and the human capital as the moderator of organizational ambidexterity i.e. combination strategy which would contribute to organizational performance much more than separately implemented strategies of exploration or exploitation. Based on the above discussions and proposed relations, managerial and further research implications can be forwarded in this final section.

Managers and members of the organized entities should decide at the beginning of the strategic planning process, about which strategic alternative to choose: exploration, exploitation, or both, i.e. ambidexterity. Considering their strategic orientation, performance goals, environmental conditions, and quality of their resources, especially human resources, strategists should make this choice. If ambidexterity is chosen as the most promising alternative, it may be implemented either by division of work or rotation in time. But the most suitable one is to manage it with high quality human resource that can face the conflicts and problems raised by the duality of purpose.

As for the further research implications, the above proposed model of relations should be tested on a large sample of organizations or strategic business units from various countries, markets, and industries. Control variables such as firm characteristics and moderating variables such as environmental conditions may be added to the model. Also, various performance indicators such as operational efficiency, flexibility, innovation, etc. may be operationalized and used as dependent variables. Beside the primary survey data for strategic orientations and choices, secondary data for performance indicators, firm characteristics, and environmental conditions may be utilized to overcome same source biases in the data collection phase. Moreover, longitudinal studies may be conducted to uncover long-term cause and effect relationships among all these strategic variables.

We can finally conclude that ambidexterity is a difficult strategy to implement unless the organizational milieu, human resources, and environmental conditions are suitable. If planned and implemented in a balanced way, ambidexterity proves to be a critical strategic concept which is promising long-term performance.

# REFERENCES


1. Adler P. S., Goldoftas B., Levine D. I. (1999) “Flexibility Versus Efficiency? A Case Study of Model Changeovers in the Toyota Production System” Organization Science 10 (1): 43-68
2. Auh S., Mengüç B. (2005) “The influence of top management team functional diversity on strategic orientations: The moderating role of environmental turbulence and inter-functional coordination” International Journal of Research in Marketing, 22(3): 333-350
3. Barney, J.B., (1986) “Strategic factor markets: Expectations, luck and business strategy” Management Science, 32 (10): 1231-1241
4. Burgelman R. A. (1991) “Intraorganizational Ecology of Strategy Making and Organizational Adaptation: Theory and Field Research” Organization Science, 2 (3): 239-262
5. Burgelman, R.A. Grove, A.S. (2002) “Strategy is Destiny, How Strategy-making shapes a Company’s Future” Free Press
6. Burns, T., Stalker, G. M. (1961) “The management of innovation” London, Tavistock.
7. Duncan, R.B. (1973) “Multiple decision making structures in adapting to environmental uncertainty” Human Relations, 26:273-291
8. Duncan, R.B. (1976), "The ambidextrous organization: designing dual structures for innovation", The Management of Organization: Strategy and Implementation 1:167-88.
9. Gibson, CB; Birkinshaw, J (2004) “The antecedents, consequences, and mediating role of organizational ambidexterity” Academy of Management Journal, 47 (2): 209-226
10. He, ZL; Wong, PK. (2004) “Exploration vs. exploitation: An empirical test of the ambidexterity hypothesis” Organization Science, 15 (4): 481-494
11. Johnston, H. R. (1976) Interactions between individual predispositions, environmental factors, and organizational design, In R.H. Killman, L. R. Pondy and D.P. Slevin (Eds.) The management of Organizational Design, New York, 2: 31-58

12. Kyriakopoulos K. and Moorman, C. (2004) “Tradeoffs in marketing exploitation and exploration strategies: The overlooked role of market orientation” International Journal of Research in Marketing 21 (3): 219–240.
13. Lin, Z., Yang, H., Demirkan, I. (2007) “The Performance Consequences of Ambidexterity in Strategic Alliance Formations” Management Science, 53(10):1645-1658
14. March, J. G. (1991) “Exploration and exploitation in organizational learning” Organization Science, 2( ):71-87
15. Menguc, B.; Auh, S. (2008) “The asymmetric moderating role of market orientation on the ambidexterity-firm performance relationship for prospectors and defenders” Industrial Marketing Management, 37 (4): 455-470
16. Narver JC, Slater SF, MacLachlan DL, (2004) “Responsive and proactive market orientation and new-product success” Journal Of Product Innovation Management 21 (5): 334-347
17. Porter, M.E. (1980), Competitive Strategy: Techniques for Analyzing Industries and Competitors, Free Press, New York, NY.
18. Raisch, S.; Birkinshaw, J. (2008) “Organizational ambidexterity: Antecedents, outcomes, and moderators” Journal Of Management, 34 (3): 375-409
19. Tushman, M. and O’Reilly, C. (1996) “Ambidextrous Organizations” California Management Review, 38(4):8-30.

# *RESOURCE BASED VIEW*
# *&*
# *CULTURE*
# *&*
# *STRATEGY*

# RESOURCE BASED VIEW OF INTANGIBLES ON ERP SYSTEMS IMPLEMENATION AND ORGANISATIONAL PERFORMANCE IN CHINA

**Jo Rhodes**
**Macquarie University**

**Peter Lok**
**University of Sydney**

**Song Yang**
**Mary Bambacas**
**University of South Australia**

## ABSTRACT

*The aim of this study is to determine the relative impact of intangible resources on effectiveness of ERP (Enterprise Resource Planning) system implementation and organisational performance. This study uses survey data from 261 senior executives employed either in the People's Republic of China (PRC) firms, or in China-based foreign joint-venture firms. The structural equation model (SEM) analysis revealed that of the tested intangible resources employed for ERP system implementation; strategic alignment/leadership engagement, and corporate culture had the greatest positive impact on the effectiveness of IT system implementation respectively; resulting in a higher non-financial performance. Contrary to expectations the local Chinese employee values/culture construct exhibited minimal influence on the effectiveness of IT implementation and organizational performance.*

*Key words: resource based view, human resource management, cross cultural management, business performance management, technology transfer, organization and management, competitive advantage.*

## INTRODUCTION

Studies based on the Resource Based View (RBV) (Powell and Dent-Micallef, 1997, Hatch and Dyer, 2004, Barney and Clark, 2008, Peter and Waterman, 1982) suggest that intangible assets related to IT use (such as culture, trust, HR practices and IT management skills) could have a significant impact on organisational performance. As intangible assets are more difficult for rivals to replicate they could contribute significantly to the competitiveness of a firm. However, there are few empirical studies that explore the influence of intangible resources on IT effectiveness and organisational performance; this study will contribute to this identified gap.

This study investigates the relative impact of key intangible factors on the effectiveness of IT implementation in China, particularly in regard to enterprise resource planning (ERP) systems. Although many critical success factors have been suggested (mainly tangible factors such as hardware and software integration) this study focuses on intangible factors (Somers and Nelson, 2001; Nah et al., 2001; Zhang et al., 2003; Umble et al., 2003) (Table 1). A review of previous studies underscored the grouping of these intangibles into three constructs: (1) HR practices; (2) leadership decision and strategic alignment; (3) and a sharing and trusting organisational culture.

Table 1. The CSFs Importance from the Literature

| Author / importance | Somers (2001) | Nah (2001, 2002) | Zhang (2003) | Umble (2003) |
|---|---|---|---|---|
| 1 (very important) | top management support | ERP teamwork and composition | Effective project management | clear understanding of strategic goals |
| 2 | project team competence | change management program culture | user involvement | commitment by top management |

| | | | | |
|---|---|---|---|---|
| 3 | inter cooperation | top management support | top management support | excellent project management |
| 4 | clear goals and objectives | business plan and vision | vendor support | organizational change management |
| 5 | project management | business process reengineering | education & training | a great implementation team |
| 6 | inter communication | project management | Company wide commitment | data accuracy |
| 7 | management of expectations | monitoring and evaluation of performance | reengineering business process | extensive education and training |
| 8 | project champion | effective communication | data accuracy | focused performance measures |
| 9 | Vendor support | software development | suitability of software & hardware | Multi-site issues |
| 10 (general important) | Careful package selection | testing and trouble shooting | Organizational cultures | |

As it is well established that different cultural groups have unique values and beliefs which could affect work behaviours an additional intangible construct of employee values/culture was added; for example collective behaviour is more common in some cultures (House et al., 2001, Hofstede 2001, and Smith et al., 2002). Furthermore, since the majority of participants (98%) in this study were Chinese, Chinese values were included to determine whether personal values/culture influences the effectiveness of ERP IT implementation (Pudelko, 2005).

The contributions of this research are three fold. First, we propose to extend the existing resource based theory to include key IT intangible assets as an integral component to achieve competitive advantage. Second, the framework in this study determines the relative impact of these particular intangible assets on the effectiveness of IT implementation in securing increased organisational performance based on the RBV of the firm; the research results could extend management insights as to the relative value of these intangibles in strategy formulation. Third, with the rapid convergence of best practices, the effect of employee personal values (Chinese employees' values) as an intangible influence on IT implementation to secure high performance is explored. This phenomenon is becoming increasingly relevant due to the expansion of ERP IT system implementations in China by both local and foreign firms. With the increase in convergence of best practice in international business, the working behaviours, values and national culture of local Chinese employees could be an important element in successful IT implementation and organisational performance.

# IT SYSTEMS AND ORGANISATIONAL PERFORMANCE

ERP systems are considered to be value creation strategic tools whereby value is derived through: operational performance improvements (Cotteleer and Bendoly, 2006; McAfee, 2002; Hendricks et al., 2007); cost reductions; and customer service improvements (Shang and Seddon, 2002; O'Leary, 2004). Translating this conceptual value into concrete value has proved illusive for many firms as ERP systems are complex; implementation requires an organisation wide transition to align business and organizational processes, human skills, resources, structure and culture (Liang et al., 2007).

These implementation complexities often result in high failure rates with around 80% of ERP system implementations reported as late, over budget, and/or under-delivering on the anticipated benefits (Başoglu, Daim and Kerimoglu 2007, Martin, 1998). Despite these poor statistics, firms continue to adopt these systems as part of their overall strategy to develop competitive advantage. The uptake of ERP systems, first introduced into China at the beginning of the 1980s, was initially slow. Since then, ERP system sales have substantially increased. In 2006, the total ERP system sales (including Western and Chinese made systems) reached 4 billion Yuan (around US$ 570 million). The number of enterprises adopting these IT systems was around 3000, which is only 3.8% of total enterprises in China (E-work, 2004, 2006). Overall, 12% of firms reported that they were totally dissatisfied with their ERP performance and only 8% of the firms reported total satisfaction. More than half of the firms in China (both local and foreign firms) that implemented ERP systems were dissatisfied with the expected performance outcomes (Xue et al. 2006, E-work, 2006)

A review on the effectiveness of ERP systems in China uncovered a number of common success factors including: alignment of strategy, management support, corporate culture, user involvement, training, integration of software and hardware, vendor support, project evaluation processes, communication (Ho, Wu

& Tai, 2004), human resource practices (Loh and Koh, 2004, Reimer 2003), organisational culture (Zhang et al., 2003) and implementation (Wang, Xu, Liu and Qin 2005, Loh and Koh 2004, Xin 2004,). These findings are consistent with results from the West (Banker et al., 2000; Reimers, 2003; Shanks et al., 2000; Loh and Koh, 2004).

# THE FOUR INTANGIBLES IN THIS STUDY

Many ERP IT implementation critical success factors, and their respective relative importance (as summarised in table 1) ranging from hardware (tangibles) compatibility to organisational and human factors (intangibles) have been discussed in the literature (Hong and Kim 2002; Nah et. al., 2001; Umble et. al., 2003; Somers, 2001; Soh et. al., 2001; Davison, 2002; Reimer, 2003). A review of these critical factors indicates that intangible factors can be grouped into three broad categories: human resource practices; strategic alignment and leadership engagement; and a trusting and sharing corporate culture. In addition, this study includes employees' values as one of the RBV (resource based view) intangibles since the majority of employees are Chinese and the influence of these employees' value on work practices and IT implementation in China is relatively unknown.

## Local human resource practices

Since human capital is an important capability required to sustain corporate performance, HR practices (an intangible factor) in the firm are expected to have an important influence on the successful adoption and implementation of ERP IT systems for high organizational performance. For example, Chan, Shaffer and Snape (2004) and Huselid, Jackson and Schuler (1997) have argued that rigorous hiring and retention procedures, performance based rewards, extensive training and development programs, planned succession policies and employee involvement are important HR practices that contribute to high organizational performance. Evidence demonstrates that HR practices such as recruitment, reward and performance management may be different in China as compared to the West (Cunningham and Rowley 2007; Warner, 2003; Jaw et al., 2007; Fang 2000). This suggests that the alignment of local HR practices (e.g. performance management, autonomy, reward systems, career development and training) could significantly influence the success of ERP IT implementation and positive organisational performance in China. Consequently it is expected that:
H1: Local HR practices have a positive effect on ERP IT system implementation in China

## Strategic alignment and leadership engagement

Strategic alignment and leadership engagement can influence the effectiveness of ERP IT system implementation. Leadership engagement with HRM, alignment of competencies and capabilities, leadership vision and change readiness, and involvement of employees in planning and innovation could greatly enhance the competitive advantage of the firm (Hitt, Bierman, Shimizu and Kochhar, 2001). Barney and Clark (2008), argue that the strategic alignment of corporate goals with organisational capabilities and resources is critical to achieve competitive advantage. As studies on the critical success factors of ERP IT system implementation in China (Loh and Koh, 2004; Soh et al., 2000; Zhang et al., 2003; Wang, 2003) highlighted the importance of strategic alignment and leadership engagement in realizing organizational benefits from ERP IT systems it is expected that:
H2: Strategic alignment and leadership engagement have a positive effect on ERP IT system implementation in China

## Corporate culture (knowledge sharing, teams and trust)

Corporate culture dimensions such as: pride in high quality outputs; open and transparent communication; trust; innovation; belief and commitment to accountability; knowledge sharing; collegial support, team cohesion; and shared vision and values are well documented as being crucial to attaining a high performance culture (Kalliath et al., 1999; Goffee, 2003; Trice and Beyer, 1993). Previous studies concluded that knowledge sharing (at the firm level) could increase the level of IT use, increase operational and service performance of the firm (Nelson and Cooprider, 1996) and increase IT assimilation in value-chain activities and business strategies (Armstrong and Sambamurthy 1999).

Based on the RBV, intangibles such as knowledge-sharing, trust, and other organisational culture variables (e.g. leadership empowerment, openness and innovation) must be exploited effectively to optimise the value of both tangible and intangible IT assets. The influence of corporate culture on ERP IT system implementation in China was highlighted by Loh and Koh, 2004; Soh et al., 2000; Zhang et al., 2003. They concluded that the main corporate culture barriers to effective ERP IT system implementation were: hierarchical control and bureaucratic policies; top down decision making and the lack of empowerment; and poor performance management controls. Since a number of studies (Davison 2002, Reimer, 2003, Soh et al., 2002; Nah et al., 2002) argue that corporate culture is a significant success factor in ERP IT system implementation, this suggests that corporate culture may have a higher impact on the effectiveness of ERP IT system implementation as compared to the other three independent variables. Therefore it is expected that:
H3: Corporate culture (knowledge sharing, trust and teams) has the highest positive effect on ERP IT system implementation as compared to the other three independent variables, namely HR practices, strategic alignment/leadership and Chinese values.

## Chinese employee culture/value

Whilst the convergence of global best practices and technology increases competition among firms, national cultures can impact on how global best practices are adopted (von Glinow et al., 2002). Past studies acknowledge that divergence in national cultures, such as Confucian values and high power distance in Asian countries, have to be managed effectively to achieve the desired organisational performance outcomes (Huo, Hang and Napier, 2002; Ralston et al., 1992). Thus, foreign firms need to “think global, and act local” to integrate into the local market. As the effect of local Chinese employees’ culture and values on organizational performance is highlighted in a number of studies (Jaw et al., 2007; Cummingham and Rowley 2007; Ralston et al., 1992), and since the majority of employees in this study are local Chinese, it is expected that:
H 4: Chinese culture/values have a significant effect on ERP IT system implementation in China

# ORGANIZATIONAL PERFORMANCE MEASUREMENT

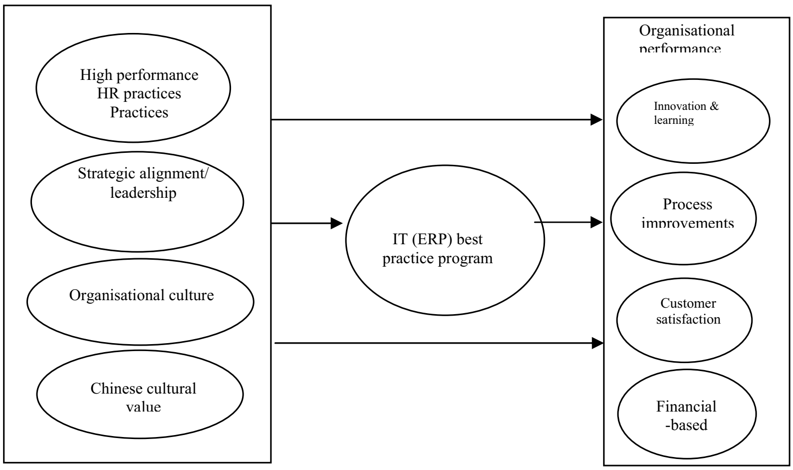
Traditional organisational performance measurements are based on financial results. However, financial results are historical and whilst they may serve as an estimate for future growth, this is a weak proxy for future performance. A more robust measure of organizational performance is the balanced scorecard system whereby a fuller range of potential growth factors, and the firm’s strengths, can be included. Kaplan & Norton (2001) proposed that organizational performance can be assessed holistically through employee innovation/learning, process improvement, customer satisfaction and financial results. It is often assumed that an effective ERP IT system will result in greater organisational performance. Based on the balanced scorecard approach, organisational performance can be expressed in both financial and non-financial (operational) outcomes. Since performance studies in the past have focused on financial metrics, the holistic balanced scorecard approach of performance measurement is limited and inconclusive. Hence, it is expected that:

H5: There is a direct positive relationship between successful ERP IT system implementation and higher organizational financial performance (based on financial figures and customer market share).
H6: There is no direct positive relationship between successful ERP IT system implementation and higher organizational human and operational performance (employee innovation/learning and process improvement).

# THE CONCEPTUAL FRAMEWORK

The conceptual framework (Figure 1) used in this study is based on four key intangible independent variables: (1) local high performance HR practices; (2) strategic alignment and leadership engagement; (3) knowledge sharing and a trusting corporate culture; (4) and Chinese values/culture. The mediator (intervening variable) is effectiveness of ERP IT implementation. The dependent variable is organisational performance as measured with the balanced scorecard categories. Although the ERP IT system is the mediator in this study, there may be certain direct effects on organizational performance from the independent variables.

Figure 1. The Conceptual Model for the Impact of IT (ERP) on Organisational Performance




Independent variables = high performance HR practice, strategic alignment/leadership, organisational culture and Chinese culture/values; Mediating variable = IT (ERP) best practice program
Dependent variable = organisational performance base on the Balanced scorecard framework

# DESIGN/METHODOLOGY

Data was collected using a survey instrument; the data was analysed using Structural Equation modelling to obtain the best fit model and path for this study.

## Sampling approach

This study used a relationship sampling approach considered necessary in China because personal contacts (guanxi) significantly facilitate company access (Easterby-Smith and Malina, 1999). Access to these companies was gained through the researcher's previous contacts. Snowballing techniques then obtained contacts of contacts. The sample companies were from multiple locations in China, with the majority from Shanghai, Guangzhou, Xiamen, Beijing, Tianjin, Kunming and Chengdu. Out of the initial 380 contacts of contacts, 261 returns were obtained; 199 returns were from Chinese firms and 62 returns from foreign joint venture firms. 4 returns were from solely foreign firms. Since the solely foreign firm category had too few responses for meaningful statistical analysis it was discarded (after a detailed review of the responses in these 4 surveys to ensure that there were no major differences between them and the foreign joint venture responses).

The anonymous questionnaire (in Chinese), covering letter, and self-addressed return envelope were forwarded to the chief executive officer (CEO). The covering letter (in Chinese) explained the purpose of the research, and requested the questionnaire to be completed only by either the chief operation officer, or any senior executive in the company (that is CFOs and COOs). The survey was translated into Chinese from the original English research questionnaire using a thorough back-translation method.

## Measures

The questionnaire was structured into six parts. There were four independent variables: Local HR practices; corporate culture (trust, knowledge sharing and teams); strategic alignment and leadership; and Chinese values. The mediating variable was effectiveness of the ERP IT system implementation. The dependent variable was organizational performance. The two factors in organizational performance were financial and non-financial (operational) performance. The items for local HR practices were selected from the Huselid et al., (1997) survey. The items for corporate culture were adopted from Kalliath's (1999) organisational cultural survey. Items for strategic alignment were adopted from Bjorkman and Fan's (2002) survey. Items for Chinese values were adopted from Ralston et al.,'s (1992) survey; Confucian values such as harmony with others, loyalty to superiors, respect for tradition, and protection of 'face', were included. The items for effectiveness of the ERP IT system implementation were adopted from Xin (2004). The items for organizational performance were adopted from Delaney and Huselid (1996). Since actual financial and performance data is sensitive and therefore difficult to obtain from firms, Delaney and Huselid (1996) obtained data from senior executives through their perceived performance of the firm. The results of these perceived data is considered as comparable with real financial and performance data. The total items (Huselid's items plus additional ones) used for organisational performance in this study also reflect the balanced scorecard performance measurement approach (Kaplan and Norton, 2001) based on four components: financial, customer satisfaction, process improvement, and employee innovation/learning. All items were structured based on the Likert scale ranging from: strongly disagree of 1 to strongly agree of 7; or not important at all as 1 to extremely important as 7. Demographic data such as number of employees, ownership, industry type and location were also collected.

# RESULTS

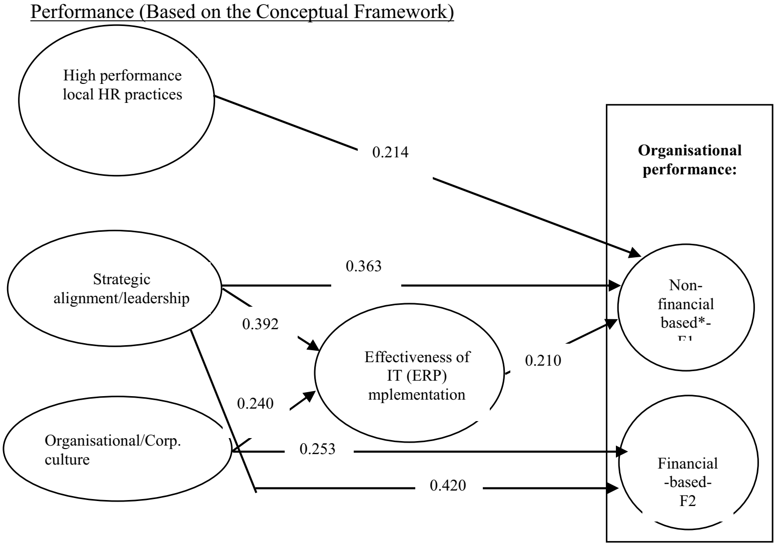
## Multi-group analysis for Chinese and foreign joint ventures

A multi-group analysis was conducted to determine the possible differences in the effectiveness of ERP IT system implementation and organisational performance between the Chinese and foreign joint venture groups. Data from these two groups (199 and 62 respectively) were entered into the baseline (non-constraint) model and the constraint model simultaneously. The series of Chi-Square tests indicated that there was no statistical difference between these two groups in terms of measurement weights, structural weights, structural covariance, structural residuals and measurement residuals.

## Results of confirmatory and structural models

The results demonstrate that all variables had high reliability indexes ranging from 0.826 to 0.953. The results of the confirmatory factor analysis illustrated that the measurement model fitted the data reasonably well. The second step in the two-step structural equation modelling procedure (Anderson and Gerbing 1988) examines the structural weights in Figure 1. The results of this show that the model fit as well as all the path coefficients as summarised in Table 1. Model 1 in Table 1 displayed all the path coefficients while Model 2 indicated the trimmed model, in which only the significant paths were retained. The final model is presented in Figure 2.

Figure 2: Significant Direct and Indirect Impact of Independent and Mediating Variables on Organisational Performance (Based on the Conceptual Framework)




# (Non-financial Performance- F1- is measured by organisational learning, innovation, process improvement and customer satisfaction; Financial Performance –F2- is measured by profit and market share

As Figure 2 shows, the ERP IT system implementation best practice program has a direct positive effect on non-financial organisational performance measured by organisational learning, innovation, human resource management, and customer satisfaction (β=.21, p<.001). There is no statistically significant link between ERP IT system implementation and organisational performance calibrated by financial outcomes. It means that ERP IT system implementation has not made a significant contribution to performance financially to the surveyed participants in China. The strategic alignment and leadership variable is the only construct which made a direct significant contribution to both financial and non-financial performance (β=.420, p<.001 and β=.363, p<.001 respectively). Organisational culture provided a direct impact (β=.240, p<.001) in ERP IT implementation and financial performance (β=.253, p<.001). The local human resource practice has a direct positive effect on non-finance performance (β=.214, p<.001). Surprisingly, Chinese cultural values had no impact on any elements in the model.

Table 1 Standardised Structural Equation Estimation

| Standardised Path Coefficients | Model 1 | Model 2 |
|---|---|---|
| Strategic alignment to Performance (F1) | 0.374*** | 0.363*** |
| Strategic alignment to Performance (F2) | 0.417*** | 0.420*** |
| Organisational culture to Performance (F1) | 0.045 | |
| Organisational culture to Performance (F2) | 0.180* | 0.253*** |
| Human resource practice to Performance (F1) | 0.184* | 0.214*** |
| Human resource practice to Performance (F2) | 0.061 | |
| Chinese cultural value to Performance (F1) | - 0.069 | |
| Chinese cultural value to Performance (F2) | 0.071 | |
| Strategic alignment to IT (ERP) | 0.385*** | 0.392*** |
| Organisational culture to IT (ERP) | 0.188* | 0.240*** |
| Human resource practice to IT (ERP) | 0.097 | |
| Chinese cultural value to IT (ERP) | -0.021 | |
| IT (ERP) to Performance (F1) | 0.180** | 0.210*** |
| IT (ERP) to performance (F2) | 0.032 | |
| Model goodness of fit statistics | | |
| Chi-square | 437.00 | 371.33 |
| Degree of freedom | 167 | 141 |
| P-value | 0.000 | 0.000 |
| Goodness of Fit Index (GFI) | 0.874 | 0.880 |
| Tucker-Lewis Index (TLI) | 0.913 | 0.918 |
| Comparative fit Index(CFI) | 0.930 | 0.932 |
| Root Mean Square Error Approximation (RMSEA) | 0.078 | 0.079 |

Notes: * denotes that the path coefficient is significant at the 0.05 level, ** denotes that the path coefficient is significant at the 0.01 level, and *** denotes that the path coefficient is significant at the 0.001 level. Performance (F1): performance measured by non-finance elements (organisational learning, innovation, human resource management, and customer satisfaction); Performance (F2): performance measured by finance outcomes and market share.

# DISCUSSION AND CONCLUSION

The final model revealed that only "strategic alignment and leadership engagement", and "knowledge sharing, trusting organisational culture" had a direct positive impact (β= 0.39 and 0.24 respectively) on the effectiveness of ERP IT system implementation. There is no direct impact of local HR practice on the effectiveness of ERP IT system implementation. Hence, H1: "Local HR practices should have a positive effect on ERP IT system implementation in China" was rejected. This was somewhat unexpected because of the strong evidence that local HR practices exert significant influence on the effectiveness of IT system implementation (Jaw et al., 2007, Fang, 2000). This finding may indicate that local firms that have implemented ERP IT systems have adopted HR best practices to optimise the potential benefits of ERP systems and hence this showed no significant impact when compared to the other key independent variables in this study. Alternatively, since local HR practices are standardised by the government, all firms would need to adhere to similar policies. Hence, the impact of local HR practices would be similar among firms and exhibit a weak influence on the effectiveness of ERP system implementation when compared to other independent variables. H2: "Strategic alignment and leadership engagement should have a positive effect on ERP IT system implementation in China", was accepted. This finding was expected since it has been stated that strategic alignment with corporate goals is a key factor in securing competitive advantage and high organisational performance (Barney & Clark 2008); the findings in this study showed that the alignment of strategic goals had a significant positive result on the effectiveness of ERP IT system implementation. Furthermore, the results also supported the premise that leadership engagement with employees is required in order to operationalise strategic alignment (Soh et al., 2000, Zhang et al. 2003, Wang, 2003).

Since the direct impact of organisational culture on the effectiveness of ERP IT system implementation is less than strategic alignment, H3: "Corporate culture has the highest positive effect on ERP IT system implementation as compared to the other three independent variables, namely local HR practices, strategic alignment and Chinese values", was rejected. This was also a counter intuitive finding because previous studies strongly suggested corporate culture was an important factor in effective ERP IT system implementation (Davison, 2002; Boersma and Kingma 2005; Reimer, 2003; Soh et al., 2002; Nah et al., 2002). The results also showed that Chinese employee values had no influence on ERP IT system implementation, hence H 4: Chinese culture/values have a significant effect on ERP IT system implementation in China, was rejected. This is a counter intuitive finding and could be explained through considering that globalisation and the concurrent trend of management best practice convergence may be increasingly diminishing the influence of cultural values. As discussed earlier the convergence of global best practices (mainly technical best practices - as a key corporate resource/capability) is gaining momentum and the impact of best practices on organisational performance may have overshadowed the effect of cultural values on performance (Von Glinow et al 2002). Furthermore, the results of this study indicate that the values of Chinese employees in these firms may not have significant impact on the effectiveness of ERP IT implementation as compared with other independent variables used in this study. Also, since the majority of employees in these firms were local Chinese, there may not be significant differences in the impact of national culture/values between firms. However, the divergence of national culture and its impact on organisational performance is still inconclusive given that the employees in this study were mainly Chinese (Gamble 2003, Huo et al., 2002).

Based on the result that there is only a direct impact ($\beta = 0.21$) of the effectiveness of ERP IT system implementation on non-financial based organisational performance, and no impact on the financial based, H5: "There is a direct significant relationship between successful ERP IT system implementation and higher organizational financial performance (based on financial figures and customer market share)" was rejected and H6: "There is no direct significant relationship between successful ERP IT system implementation and higher organizational human and operational performance (employee innovation/learning and process improvement)" was also rejected. This result is contrary to past expectations. Although Bharadwaj (2000) argued that information technology, as an organisational capability, would result in superior financial performance for the firm, the reality different. Xue et al., (2006) and E-work (2006) reported that more than half of the firms in China (both local and foreign firms) that implemented ERP systems were dissatisfied with their expected financial performance. However, the positive and significant relationship between ERP IT system and non-financial performance was unexpected. This may reflect that the IT system implementation could have a positive influence on how people learn and work in the firm, hence, changing the relationships among employees, team cohesiveness, learning and sharing opportunities and the corporate culture in general. That is the ERP IT system may not yet have had an impact on the financial performance of the firm, but the positive corporate culture supported by the ERP IT system may eventually provide the expected financial outcome. However, this is an area which requires further longitudinal research.

Finally, the results of this study provide insights into the direct effect of strategic alignment and leadership on both financial and non-financial organisational performance ($\beta = 0.42$ and 0.36 respectively). Furthermore, the total effect (via ERP IT system implementation) of strategic alignment and leadership on non-financial performance is higher than organisational culture ($\beta$ value, $0.39 \times 0.21 = 0.08$ and $0.24 \times 0.21 = 0.04$ respectively). This further supports the relative importance of strategic alignment and leadership as an important intangible factor for ERP IT system implementation and organisational performance.

## REFERENCES

Anderson, J. C. and Gerbing, D. W. (1988), Structural equation modelling in practice: a review and recommendation of two-step approach. *Psychological Bulletin.* 103*,* (3): pp.411-423.

Armstrong, C and Sambamurthy, V. (1999), Information technology assimilation in firms: the influence of senior leadership and IT infrastructure, *Information Systems Research*, 10, (4) pp.304-327

Banker, R., Janakiraman, S., Konstans, C., and Slaughter, S. (2000), *Determinants of IT (ERP) adoption: an empirical analysis,* School of Management, The University of Texas at Dallas, working paper.

Basoglu, N., Daim, T. and Kerimoglu, O. (2007), Organisational adoption of enterprise resource planning systems: a conceptual framework, *Journal of High Technology Management Research,* 18 (1) pp.73-97

Barney, J. & Clark, D., (2008), *Resource-Based theory: creating and sustaining competitive advantage*, Oxford, Oxford University Press

Bharadwaj, A. (2000), A resource based perspective on information technology capability and firm performance – an empirical investigation, *MIS Quarterly*, 24,(1): pp.169-196

Bjorkman, I. and Fan, X. (2002), Human resource management and the performance of Western firms in China. *International journal of Human Resource Management*. 13: pp.853-864

Boersma, K., and Kingma, S. (2005), Developing a cultural perspective on IT (ERP), *Business Process Management Journal*, 11, (2): pp.123-136

Chan, L. Shaffer, M. and Snape, E. (2004), In search of sustained competitive advantage: the impact of organizational culture, competitive strategy and human resource management practices on firm performance. *International Journal of Human Resource Management*. 15: pp.17-35

Cotteleer, M. & Bendoly, E. 2006. Order lead-time improvement following enterprise-IT implementation implementation: An empirical study. *MIS Quarterly.* 20: pp.643-667.

Cunningham, L. and Rowley, C. (2007), Human resource management in Chinese small and medium enterprises– a review and research agenda, *Personnel Review*. 36, (3): pp.415-439

Davison, R., (2002), Cultural complications of IT (ERP). *Communications of the ACM*, 45, (7): pp.109-111

Delaney, J., and Huselid, M. (1996), The impact of human resource management practices on perceptions of organizational performance. *Academy of Management Journal*, 39, (4): pp.949-969

Easterby-Smith, M. and Danusia, M. (1999), Cross-cultural Collaborative Research: Toward Reflexivity. *Academy of Management Journal*. 42, pp.76-86.

e-work (2006), IT (ERP) marketing enters the replace time, http://www.ccw.com.cn/cio/research/qiye/htm2006/20061228_232748.asp. Access: 28 Oct. Dec., 2006.[In Chinese]

Fang, Y. (2000), The effect of distributive preferences on decisions: an empirical study of Chinese employees, *Cross cultural management – an international journal*, 7, (1): pp.3-11

Goffee, R. (2003), The character of a corporation, London, Harper Collins.

Hatch, N. and Dyer, J. (2004), Human capital and learning as a source of sustainable competitive advantage, *Strategic Management Journal*, 25 (12) pp.1155-1178

Hendricks, K., Singhal, V. and Stratman, J. (2007), The impact of Enterprise systems on corporate performance: A study of ERP, SCM and CRM system implementation, *Journal of Operations Management,* 25 (1): pp.65-103

Hitt, M., Bierman, L., Shimizu, K. And Kochhar, R. (2001), Direct and moderating effects of human capital on strategy and performance in professional service firms: a resource-based perspective, *Academy of Management Journal*. 44: pp.13-38

Ho, C., Wu, W. and Tai, Y. (2004), Strategies for the adaptation of IT (ERP) systems, *Industrial Management and Data Systems*. 104, (3): 43-53

Hofstede, G. (2001), *Cultures' consequences: comparing values, behaviours, institutions and organizations across nations*, Sage, London

Hong, K. and Kim, Y. (2002), The critical success factors for IT (ERP) implementation: an organizational fit perspective. *Information and Management*, 40, (1):pp.25-41

House, R., Javidan, M. and Dorfman, P. (2001), Project Globe – an introduction, *Applied Psychology*, 50 (4) : pp.489-505

Huo, P., Huang, H. and Napier, N. (2002), Divergence or Convergence: a cross national comparison of personnel selection practices. *Human Resource Management*. 41, (1)**:** pp.31-44

Huselid, M., Jackson, S. and Schuler, R. (1997), Technical and strategic human resource management effectiveness as determinants of firm performance. *Academy of Management Journal*, 40, (1):pp.171-186

Jaw, B., Ling, Y., Wang, C. and Cheng, W. (2007), The impact of culture on Chinese employees' work values. *Personnel Review*. 36, (5):pp.763-780

Kaplan R. and Norton D. (2001), *The Strategy-Focused Organisation*. Boston, Harvard Business School Press

Kalliath, T., Bluedorn, A. and Gillespie, D. (1999), *Educational and Psychological Management*, 59, (1): pp.143-157

Loh, T.C. and Koh, S.C.L. (2004), Critical elements for a successful ERP implementation in SMEs. *International Journal of Production Research*, 42, 17: pp.3433-3455.
: a quantitative model for organisational learning. *International Journal of Information Technology and Management (IJITM).* 6, (1): pp.35-47

Martin, M.H. (1998), An IT (ERP) strategy. *Fortune*, February: pp.95–97

McAfee, A. (2002), The Impact of Enterprise Information Technology Adoption on Operational Performance: An Empirical Investigation, *Production and Operations Management.* 11 (1): pp.33-53

Nah, F., Lau, J. and Kuang, J. (2001), Critical factors for successful implementation of enterprise systems. *Business Process Management Journal*, 7: pp.285–296.

Nelson, K. and Cooprider, J. (1996), The contribution of shared knowledge to IS group performance, *MIS Quarterly*, 20 (4): pp.409-432

Peters, T and Waterman, R. (1982), *In search of excellence*, Harper Collins, London

Powell, T. and Dent-Micallef, A. (1997), Information technology as competitive advantage: the role of human, business, and technology resources, *Strategic Management Journal*, 18 (5): pp.375-405

Pudelko, M. (2005), Cross-national learning from best practice and the convergence and divergence debate in human resource management, *International Journal of Human Resource Management*, 16 (11): pp.2045-2074

Ralston, D., Gustafson, D., Elsass, P. and Cheung, F. (1992), Eastern values: a comparison of managers in the United States, Hong Kong and the People's Republic of China. *Journal of Applied Psychology.* 77:pp. 664-671

Reimer, K. (2003), Implementing IT (ERP) in China. *Communications of the Association for Information Systems*, 11: pp.225-365

Shanks, G., Parr, A., Hu, B., Corbitt, B. and Seddon, P. (2000), Differences in critical success factors in IT (ERP) systems implementation in Australia and China: a cultural analysis, in *Proceedings of the 8th European Conference in Information systems*, July 3-5, Vienna, Austria. Pp.127-136

Smith, P., Peterson, M. and Schwartz S. (2002), Cultural Values, Sources of Guidance, and their Relevance to Managerial Behavior, *Journal of Cross-Cultural Psychology*, 33 (2):pp. 188-208

Soh, C., Sia, S. and Tay-Yap. J. (2000), Cultural fits and misfits: Is IT (ERP) a universal solution. *Communications of the AC.,* 43 (4): pp.14-19

Somers T. and Nelson K. (2001), The impact of critical success factors across the stages of enterprise resource planning implementations. In *Proceedings of the 34th Hawaii International Conference on System Sciences (HICSS.* Hawaii).pp.210-219

Trice, H. and Beyer, J. (1993), *The culture of work organization*, NJ, Prentice Hall.

Umble E.J., Haft R.R. and Umble M.M. (2003), Enterprise resource planning - Implementation procedures and critical success factors. *European Journal of Operational Research*, 1, 46: pp.241-57.

Von Glinow, M.and Teegarden, M. (2002), Converging on IHRM best practices: lessons learned from globally distributed consortium on theory and practice, *Human Resource Management*, 41(1),pp.123-140

Xin, H. (2004), The IT (ERP) challenge in China: a resource based perspective. *Information System Journal*, 14, pp.153-167

Xue, Y., Liang, H., Boulton, W.R. and Snyder, C.A. (2006), IT (ERP) implementation failures in China: case studies with implications for IT (ERP) vendors. *International Journal of Production Economics,* 100, (1), pp. 279-295.

Wang, C., Xu, L., Liu, X. and Qin, X. (2005), IT (ERP) research, development and implementation in China: an overview, *International Journal of Production Research*, 43 (18), pp. 3915-3932

Wang, H. (2003), Analysis of the capacity mature degree of IT (ERP) system implementation in domestic business enterprise, *Scientific Management Research*, 21 (3), pp. 60-64. [In Chinese]

Warner, M. (2003), China's HRM revisited: a step-wise path to convergence, *Asia Pacific Business Review,* 9 (4), pp. 15-31

Zhang L., Lee M.K.O., Zhang Z. and Banerjee P. (2003), Critical success factors of IT (ERP) implementation success in China. *Proceedings of the 36th Hawaii International Conference on System Sciences* (HICSS 2003),pp. 236-245

# THE EFFECTS OF GENERIC STRATEGIES AND BUSINESS CAPABILITIES ON BUSINESS PERFORMANCE

**A.Zafer ACAR**
**Okan Üniversitesi, Istanbul, Turkey**

**Cemal ZEHİR-Mehtap ÖZŞAHİN**
**Gebze Institute of Technology, Kocaeli, Turkey**

## ABSTRACT

*Resource-based view and the positioning theory are the two main approaches which consider as contrary to each other in order to achieve competitive advantage and superior business performance. In this study, the main subject is to harmonize these two theories with a research model which based on the assumption that business strategy is more effective when pursued with related capabilities. To perform the study, we conducted a questionnaire survey with 445 owners/executives of manufacturing firms. We measured business capabilities in terms of management, production, marketing and sales, information system, logistics and external relationship. Data have been analyzed through structural equation modeling. As a result, separate and harmonize effects of resource-based business capabilities (BC) and competitive strategies (CS) on business performance have been examined.*

***Keywords:****Resource-based view, business capabilities, competitive strategies, competitive advantage, structural equation modeling.*

## INTRODUCTION

One of the main questions in strategic management field is why some firms in the same industry have systematically performed better than others? It is usually assumed that well planned strategy will lead the business performance. If the answer was only the "business strategy", when lower performed firms imitate the same strategy they should perform as the same. So there must be other issues under the performance differences.

There are two main approaches try to explain the performance differences among the firms in the same industry. These two approaches, which considered as contrary to each other, are strategically based on competitive position and resource-based view (RBV).

Traditionally strategy has taken greater notice of the external environment and hence put more emphasis on external analysis. Positioning theory deals with analysis of the external environment of business as the starting point of the corporate strategy. It analyzes the firm's position on the market and makes such strategic plans to exploit the opportunities on markets. Porter's works (1980, 1985) have an important place in the Positioning School which sees the fundamental role of strategy as positioning the firm for the future. His premise is that some industries are intrinsically more attractive than others. Thus, a business should have access to the possible strategic positions in the market and select the most efficient one among these positions. Followers of the positioning theory suggest that analyzing of external environment should result in decision about which was the advantageous position in market (Porter, 1985). The basic determinant of this strategic aspect of the business positioning strategy is five-force model (Porter, 1985) or similar external analysis.

RBV (Penrose, 1959; Wernerfelt, 1984; Barney, 1991) advocates a contrary view to acquire strategically advantageous position. This theory deals with the resource base of the business itself as a starting point. RBV theorists (Wernerfelt, 1984; Barney, 1986, 1991; Grant, 1991; Peteraf, 1993) argued that firms need to achieve competitive advantage to give response to ever-changing market conditions through strategically deploying resources and capabilities within the firm and adding new capabilities to existing ones. Consequently, if the organizations or strategic business units (SBU) are able to deploy their resources and skills strategically, they will convert competitive struggle to their own interests in the best way and create a sustainable competitive advantage.

These two theories and related researches have emerged independently. Thus, studies that conducted independently and made use of various measurement instruments, leading to disparate results. Furthermore, most of the researches involved one of these two approaches while ignoring the other. Especially, there has been a major increase in the number of studies into RBV concept since the 1980's. Researchers have been tested the relationship between capabilities and business performance (e.g. Hitt & Ireland, 1986; Barney, 1991; Hall, 1993; Day, 1994; Droge, Vickery & Markland, 1994; Celuch *et al.*, 2002; Ray, Barney & Muhanna, 2004; O'Regan & Ghobadian, 2004) and between business strategies and business performance (e.g. Miles & Snow, 1978; Porter, 1980; Dess & Davis, 1984; Miller, 1986; Droge *et al*., 1994; Yamin, Gunesekaran & Mavondo, 1999) many times, but there is little empirical evidence about the details of those capabilities or the relationship among capabilities, strategy, and overall firm performance.

However these two theories notified as contrary to each other, in practice executives deal with both of them concurrently while making their strategic decisions. Thus, the main purpose of this study is to make a contribution to executives through give them a realistic analysis of their business internal capabilities to make their strategic decisions. Therefore, this study deals with the relationship among business capabilities (BC), competitive strategies (CS) and business performance.

To achieve this purpose our research based on the assumption that business strategy is most effective when pursued with related capabilities. That is, firm pursuing a given strategy with the proper capabilities should outperform than firms pursuing the same strategy without adequate capabilities. Thus, we created a research model depend on these two theories to test the effects of both BCs and CSs on business performance. Component factors and key variables for the constructs are identified through a literature review. Then data analyzed using SPSS 15.0 Confirmatory factor analysis (CFA) is performed using AMOS 16.0 to assess the constructs and identify the model fitness.

## THEORETICAL BACKGROUND

**Generic business strategies**

Strategic researches largely focus on factors external to the firm, such as market conditions and competition (Miller, 1986; Dess & Davis, 1984; Miles & Snow, 1978; Porter, 1980; 1985). According to Porter (1980, 1985), the key to competitive advantage was the ability to position the company against the industry competition. Porter (1980) suggests that the firm's competitive position in the industry and its strategy are determined by five forces of competitiveness (Porter, 1980). These are the threat of new entrants, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the degree of rivalry among existing competitors within the industry. A firm may pursue superior performance after careful consideration of these market forces with the goal of either selecting an attractive industry or developing a strong competitive position within an industry.

Companies may achieve competitive advantage either by having the lowest product cost or by having products which are different in ways which are valued by customers. Porter (1980) defined these strategic choices namely as cost leadership strategy and differentiation strategy.

Low cost strategy aims to create a sustainable competitive advantage by offering the lowest prices in a market based on low cost producer status or to maximize the profitability by reducing the costs to supply product or service with a competitive price. Differentiation strategy on the other hand, aims to create a unique product or service, brand image, customer loyalty, and higher margins. This view of strategy deals primarily with the opportunities and threats with which a firm must struggle. Thus it was perceived as very externally (market) oriented by Barney (1991). Contrary, he suggested an internally (resource) oriented approach to strategy.

Actually Porter's generic strategies have some inabilities to explain how firms achieve different levels of performance even when they compete within the same industry and use the same strategy. Thus, capabilities included in the strategy performance relationship. Porter himself stated, "Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value. The essence of strategy is in the activities - choosing to perform activities differently or to perform different activities than rivals." (Porter, 1996). These activities mentioned by Porter seem closely tied to the capabilities associated with the resource based theory of the firm (Lynch et al., 2000).

The focusing strategy describes the geographically positioning of the both cost leadership and differentiation strategies. And, many researchers have made a convincing case for only two truly generic business strategies, cost leadership and differentiation (Miller, 1986; Dess & Davis, 1984). Thus in our study we have took into consider these two main CSs; cost leadership and differentiation.

**Business capabilities**

BCs have attracted the attentions of researchers and executives because of their role in determining the sources of a firm's superior performance and sustainable competitive advantage (e.g. Ulrich, 1987, 1989; Ulrich & Lake, 1991; Stalk, Evans & Shulman, 1992; Hall, 1993; Day, 1994; Lado & Wilson, 1994; Celuch *et al.*, 2002; DeSaa & Garcia, 2002; Kaleka, 2002; Ray, *et al*., 2004; Ulrich & Smallwood, 2004; Vorhies & Morgan, 2005; Teece, 2007).

The theory of RBV defines capabilities as a bundle of skills and the knowledge that is strategically important to manage assets and coordinated activities effectively (Rumelt, 1984; Wernerfelt, 1984; Barney, 1991; Hall, 1993; Day, 1994; Helfat & Peteraf, 2003). However, some researchers defined the capabilities as the use of the tangible or intangible resources of a firm for the performance of a duty or action leading to the enhancement business performance, expressing through this view the dynamism of a firm's pool of resources (Amit & Schoemaker, 1993; Teece, Pisano & Shuen, 1997). Firm specific capabilities that stem from business processes and applications and which are learned through repetition are usually difficult for competitors to imitate (Dierickx & Cool, 1989; Grant, 1991). Additionally, they represent the business' own skills to use its resources through valuable, rare and non-substitutable ways to shown successful performance over its rivals. The literature suggests that firms differ based on their capabilities (Hitt & Ireland, 1986; Dierickx & Cool, 1989; Barney, 1991; Peteraf, 1993) and that the ability to develop effective capabilities is the firms' main source of competitive advantage and performance (Hall, 1993; Teece *et al.*, 1997; DeSarbo, DiBenedetto, Jedidi & Song, 2006). For this reason, the firm should diversify its capabilities and deploy them strategically – leading to greater efficiency and higher performance. In other words, the firms or SBUs which developed and managed their capabilities better than their rivals would achieve superior performance (Hitt & Ireland, 1985).

**The dimensions of business capabilities**

In the literature many different resources have been used and many different classifications have been proposed for the determination of components or categories of the BCs. The most prominent and widely used of these classification efforts is the one made by functional areas of the firms. Adopting this approach, Grant (1991) stated that it would be useful to take as a basis for classification of the BCs the standard classification of business functions. Researchers taking this approach have manifested different components of BCs. With the vast effect of technological change on the global business environment, some components of BCs have merged or become moribund and others have come into existence.

In defining the dimensions of the BCs we benefited from the classification by existing literature of operational functions compatible with the changing conditions of the current business environment. In this regard, studies made by Snow and Hrebiniak (1980), Birchall and Tovstiga (1999) and Celuch *et al.* (2002) are noticeable empirical examples for classification of the BCs by the functional areas. Additionally, several Strategic Management books (e.g. Hitt, Ireland & Hoskisson, 1999; Sadler, 2003) have replaced business capabilities by classifying them in the order of their functional areas.

In this study, the business capabilities are divided into categories as in the preliminary studies made for identification of the dimensions of the BCs. Thus, we scanned related literature and conducted interviews with academics interested with strategic management and 45 corporate executives each having MBA degree and ten years of experiences as a minimum to decide upon the sub-dimensions of the BCs. In light of these interviews, the classification of the capabilities made compatible with the operational functions, and then we have modified the dimensions of the BCs found in those previous studies (Snow & Hrebiniak, 1980; Birchall & Tovstiga, 1999; Celuch et al., 2002) which have acted as guide for this study. After the modifications, we decided to incorporate *management*, *production*, *marketing and sales*, *information system*, *logistics* and *external relationship* capabilities in our study.

Human resources are taken into consideration as critical contributors to achieve competitive advantage, by the outstanding rise of RBV in the field of strategic management. Researchers (Huselid, 1995; Huselid, Jackson & Schuler, 1997; DeSaa & Garcia, 2002) have noticed that human resources play a catalyzing role needed to create a capability from resources of a firm. Also, Grant (1991) distinguished human resources from intangible resources and defined capabilities as a complex pattern learnt by repetition on the basis of coordination between people and resources. Thus it should be said that human resource is embedded in every capability of a firm as a critical resource. For these reasons human resource management capability has not been included in this study as a distinct capability component.

# METHODOLOGY

The research plan has been stated as; establishing research model, researching for the survey questions on the literature, constructing the best fitting survey from the alternatives, reaching the participants and informing them for the survey, gathering the data, and measuring and analyzing the data to test the hypothesis.

**Hypothesis and research model**

Several authors have discussed the linkage between BCs and CSs. Porter (1980, 1985), Barney (1991) and Day (1994) suggest that firms will employ any and all capabilities to achieve their given strategy. In addition Barney (1991) presumes that capabilities are important to strategy. Therefore:

Hypothesis1: There should be a significant relationship between BCs and CSs.

Firms which developed and diversified their capabilities, and deployed them strategically, would achieve greater efficiency and higher performance than its rivals (Hitt & Ireland, 1986). In fact some significant connections between BCs and business performance were founded in previous researches (Day, 1984; Hitt & Ireland, 1986; Droge et al., 1994; Morash et al., 1996; Celuch et al., 2002). Therefore:

Hypothesis2: BCs should have positive effects on firms' financial performance.

Hypothesis3: BCs should have positive effects on firms' growth performance.

A firm may pursue superior performance after careful consideration of the market forces (Porter, 1980) with the goal of either selecting an attractive industry or developing a strong competitive position within an industry. Of particular interest to Porter's CSs, several researchers (Dess & Davis, 1984; Miller, 1986; Yamin et al., 1999; Droge et al., 2004) established linkages from CSs to firm performance. They also found somewhat stronger links to performance from cost leadership than from differentiation. Thus consistent with their findings:

Hypothesis4: CSs should be positive effects on firms' financial performance.

Hypothesis5: CSs should be positive effects on firms' growth performance.

Positioning approach of strategy was perceived as very externally (market) oriented (Barney, 1991) because of dealing primarily with the opportunities and threats with which a firm must struggle. Contrary, Barney (1991) suggested an internally (resource) oriented approach to strategy. Actually that the activities mentioned by Porter (1996), which create value, seem closely tied to the capabilities associated with the resource based theory of the firm (Lynch et al., 2000). Porter (1980, 1985), Day (1984) and Droge et al. (1994) supposed that CSs need to support by capabilities. Macmillan and Tampoe (2000) suggested that the best business strategies are those which use the capabilities of the firm to address customer needs. Actually capability accumulation without a strategy could be result with resource extravagance. On the other hand we can call the strategies without capabilities as a dream. Thus it is expected that initial effects of CSs on business performance should be mediate (Baron & Kenny, 1986) by the appropriate BCs. Therefore:

Hypothesis6: BSs should be play mediator role between CSs and business performance.

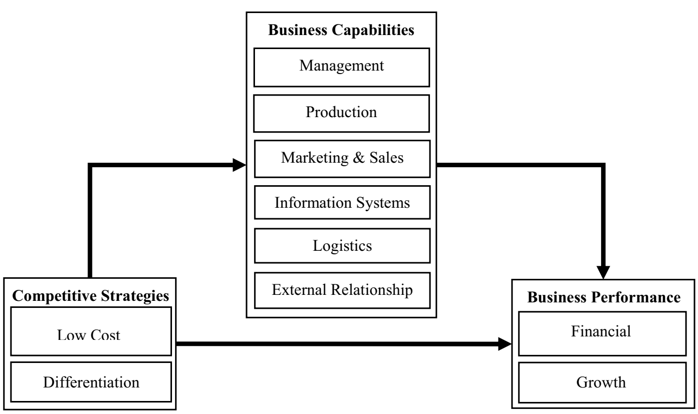



**Figure-1: Research Model**

The hypothesized relationships between independent and dependent variables of our research are depicted as a research model in Figure-1.

**Measurement instrument**

To construct the measurement instrument, we applied the methodology to develop measurement scales in social sciences (Churchill, 1979; Llusar & Zornoza, 2002). In general, the procedure that allows one to move from the concept to its measurement requires a four-stage process: literary definition of the concept, specification of dimensions, selection of observed indicators and synthesis of indicators or elaboration of indexes.

First we decided about the components of the BCs by a survey on the literature and interviews with the experts as it is explained before. After the decision about the components of the BCs, the items related to the factors which used recent studies (Morash et al., 1996; Fawcett et al., 1997; Andersen & Kheam, 1998; Yamin et al., 1999; Lee, 2001; Celuch et al., 2002; Kaleka, 2002; Rosenzweigh, 2003; Lu & Yang, 2006) were combined in the questionnaire by scanning the literature. The scale of CSs was developed based on the Porter's (1980, 1985) expressions and the variables of related researches (Dess & Davis, 1984; Slater & Narver, 1993; Lynch et al., 2000; Chang et al., 2003). We took into consider business performance in two factors; growth and profitability. This scale consist of twelve items is similar to some former studies' business performance scale (Vickery et al., 1993, 1997; Baker & Sinkula, 1999; Yamin et al., 1999; Antoncic & Hisrich, 2001; King & Zeithaml, 2001; Zahra et al., 2002; Rosenzweigh et al., 2003; Morgan & Strong, 2003).

All question sentences kept subject to "translate, reverse translate" procedure by the experts of both languages (Brislin, 1970). The draft questionnaire was reviewed and the numbers of variables were reduced by the interviews made with academics interested with strategic management. Then the preliminary form of the questionnaire was tested on 45 corporate executives each having MBA degree and ten years of experiences as a minimum. As a result of the data obtained in the preliminary survey application, the structure, validity and reliability of the measures were examined. At this phase, the variables which negatively affect internal consistency of the measurement instrument were eliminated. Finally, the questionnaire has been sent to the firms covered by our study, and asked to the respondents to evaluate their firms' BCs, CSs and business performance with seven point Likert scale.

**Data collection**

Our data were taken from medium and large sized manufacturing firms located in the Marmara Region of Turkey, most developed industrial region. A sample of 500 firms was chosen randomly from the database of Istanbul Chamber of Commerce. A total of 466 questionnaires were returned from 190 firms. Response rate was %38 at firm level. We compared early and late respondents to evaluate the non-response bias. No significant differences were found between early and late respondents on all variables. After the elimination of some questionnaire forms because of excessive data hiding and single response from a firm, 445 clear questionnaires were taken to the analysis stage. A comparison was made between the eliminated surveys and those chosen for analysis in terms of means, firm size and firm age, and it was seen that there is no difference between them in a statistical sense. After gathering the data, first we have described the basic features of data with the descriptive statistics -to provide simple summaries about respondents-. Descriptive statistics of the sample is shown in Table-1.

**Table-1: Descriptive Statistics of the Respondents**

| | | | |
|---|---|---|---|
| Level of Managers | Corporate owner (8,6 %) | Top executives (21,2%) | Medium level (70,2%) |
| Education Level | Post graduate (27,7%) | Graduate (57,8%) | Undergraduate (14,5%) |
| Industries | Metal (13.5%) | Automotive (12.1%) | Stone-soil Related (8.3%) |
| | Machinery/Metal Goods (9.2%) | Office Materials and Electronics (5.6%) | Food (8.8%) |
| | Textile (7.2%) | Various (35.3%) | |

**Validity and reliability of the measurement instrument**

First, we referred to the Cronbach's alpha test value for reliability of the scale. We found that Cronbach's alpha values have come out 0.964 for BCs, 0,965 for CSs and 0,930 for BP, and none of the items have exceed alpha coefficient of the constructs. These findings informed us the results are reliable. We also looked at the corrected inter-item correlations and it was founded out that all of the resulting values were 0,500 and above. The 'Kaiser-Meyer-Olkin test', -which inform the researchers about the adequacy level of the scales-, has come out as 0,956 for BCs, 0,959 for CSs and 0,929 for BP.

Then the PCA with varimax rotation was applied to identify component factors having eigenvalues greater than one. In the data reduction procedure those variables having a factor load of 0,500 and above were taken into the account. According to the PCA findings all items separated to their estimated factorial components without any cross loading. Factor loading values are found out between 0,515 and 0,766. Explained total variance values are found out; %69,32 for BCs and %59,74 for CSs and %67,86 for BP.

Then we confirmed the fitness of research models through CFA using the maximum likelihood (ML) estimation method. During the CFA procedure, we took into consider goodness-of-fit index (GFI) (Joreskog & Sorbom, 1996) and the root mean square residual of approximation (RMSEA) (Steiger, 1990) to evaluate absolute fit of the model. Moreover, we took into consider comparative fit index (CFI) (Bentler, 1990), normed fit index (NFI) (Bentler & Bonnet, 1980), Tucker-Lewis Index (TLI) (Tucker & Lewis, 1973) and incremental fit index (IFI) (Bollen, 1988) to evaluate incremental fit of the model. Additionally, the normed chi-square ($x^2$/df) statistic (Marsh & Hocevar, 1985) is took into consider to evaluate the parsimonious fit.

Model fit test findings showed us scales need some modifications. While examining modification indexes we recognized large error covariance between some variables. In order to determine these variables, we referred to the squared multiple correlation and regression weights. Thus, three of the BCs items, seven of the CSs items and two of the business performance items were deleted because of poor square multiple correlation and regression weight scores. Table 2 contains the fit indices of the scales after the modifications.

**Table-2: Model Fit Indexes**

| Scale | Model | Description | X2/df | GFI | CFI | NFI | TLI | IFI | RMSEA |
|---|---|---|---|---|---|---|---|---|---|
| Business Capabilities | C1 | 33 Variables, 6 Dimensions | 2,814 | ,799 | ,902 | ,856 | ,894 | ,902 | ,064 |
| | C2 | 30 Variables, 6 Dimensions | 2,927 | ,848 | ,923 | ,888 | ,914 | ,924 | ,066 |
| Competitive Strategies | S1 | 28 Variables, 2 Dimensions | 4,405 | ,797 | ,872 | ,841 | ,861 | ,872 | ,087 |
| | S2 | 21 Variables, 2 Dimensions | 4,798 | ,833 | ,901 | ,878 | ,889 | ,901 | ,092 |
| Business Performance | P1 | 12 Variables, 2 Dimensions | 5,375 | ,902 | ,936 | ,923 | ,920 | ,936 | ,099 |
| | P2 | 10 Variables, 2 Dimensions | 4,745 | ,935 | ,958 | ,948 | ,945 | ,959 | ,092 |

We performed a second level factor analysis to the BCs construct. As shown in Table-3 BC sub-factors converge to a second level single business capability factor with high factor loading values. This finding indicates convergent validity.

**Table-3: The Result of the Second Order Factor Loadings of BC**

| Components | Business Capabilities |
|---|---|
| Management | 0,808 |
| Manufacturing | 0,825 |
| Marketing and Sales | 0,854 |
| Information Systems | 0,796 |
| Logistics | 0,844 |
| External Relationship | 0,796 |
| $x^2$/df=3,004; GFI=0,844; CFI=0,918; NFI=0,883; TLI=0,911; IFI=0,919; RMSEA=0,067. All factor loading values are significant at p<0,001 ($t_{min}$=12,053) | |

The results of the CFA (Table-4) show us all items separated to their estimated factorial components distinctly and independently (Bagozzi and Phillips, 1991).

After performing correlation analysis we found that each construct which differed from each other as a factor are also correlated each other positively and significantly ($p<0.001$). Table-5 shows us, the correlation coefficients among theoretically related (convergent) constructs are higher than intercorrelation coefficients of theoretically unrelated (discriminant) constructs.

**Table-4: The Results of the Confirmatory Factor Analysis**

| | **Manage-ment** | **Manu-facturing** | **Marketing and Sales** | **Information Systems** | **Logistics** | **External Relationship** | **Cost Leadership** | **Differen-tiation** | **Financial Performance** | **Growth Performance** |
|---|---|---|---|---|---|---|---|---|---|---|
| BC01 | ,801 | | | | | | | | | |
| BC02 | ,835 | | | | | | | | | |
| BC03 | ,817 | | | | | | | | | |
| BC04 | ,843 | | | | | | | | | |
| BC05 | ,799 | | | | | | | | | |
| BC06 | ,800 | | | | | | | | | |
| BC07 | ,706 | | | | | | | | | |
| BC10 | | ,750 | | | | | | | | |
| BC11 | | ,808 | | | | | | | | |
| BC12 | | ,833 | | | | | | | | |
| BC13 | | ,842 | | | | | | | | |
| BC14 | | ,702 | | | | | | | | |
| BC15 | | | ,735 | | | | | | | |
| BC16 | | | ,845 | | | | | | | |
| BC17 | | | ,846 | | | | | | | |
| BC18 | | | ,820 | | | | | | | |
| BC20 | | | | ,846 | | | | | | |
| BC21 | | | | ,855 | | | | | | |
| BC22 | | | | ,837 | | | | | | |
| BC23 | | | | ,758 | | | | | | |
| BC24 | | | | | ,738 | | | | | |
| BC26 | | | | | ,707 | | | | | |
| BC27 | | | | | ,786 | | | | | |
| BC28 | | | | | ,728 | | | | | |
| BC29 | | | | | ,776 | | | | | |
| BC30 | | | | | ,795 | | | | | |
| BC31 | | | | | | ,719 | | | | |
| BC32 | | | | | | ,856 | | | | |
| BC33 | | | | | | ,884 | | | | |
| BC34 | | | | | | ,834 | | | | |
| CS01 | | | | | | | ,707 | | | |
| CS02 | | | | | | | ,738 | | | |
| CS03 | | | | | | | ,814 | | | |
| CS04 | | | | | | | ,742 | | | |
| CS06 | | | | | | | ,740 | | | |
| CS07 | | | | | | | ,738 | | | |
| CS08 | | | | | | | ,829 | | | |
| CS10 | | | | | | | ,786 | | | |
| CS11 | | | | | | | ,805 | | | |
| CS14 | | | | | | | ,734 | | | |
| CS15 | | | | | | | | ,756 | | |
| CS17 | | | | | | | | ,730 | | |
| CS18 | | | | | | | | ,783 | | |
| CS19 | | | | | | | | ,749 | | |
| CS20 | | | | | | | | ,782 | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| CS21 | | | | | | | | ,801 | | |
| CS22 | | | | | | | | ,826 | | |
| CS23 | | | | | | | | ,808 | | |
| CS24 | | | | | | | | ,799 | | |
| CS25 | | | | | | | | ,868 | | |
| CS26 | | | | | | | | ,731 | | |
| BP01 | | | | | | | | | ,894 | |
| BP02 | | | | | | | | | ,897 | |
| BP03 | | | | | | | | | ,814 | |
| BP05 | | | | | | | | | ,847 | |
| BP06 | | | | | | | | | ,751 | |
| BP07 | | | | | | | | | | ,752 |
| BP09 | | | | | | | | | | ,800 |
| BP10 | | | | | | | | | | ,667 |
| BP11 | | | | | | | | | | ,719 |
| BP12 | | | | | | | | | | ,768 |
| $X^2$/df=2,411; GFI=0,758; CFI=0,886; NFI=0,821; TLI=0,879; IFI=0,887; RMSEA=0,056 All factor loading values are significant at $p<0,001$ ($t_{min}$=13,788) | | | | | | | | | | |

**Table-5: Correlations of All Factors in the Research Model**

| Components | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. Management | 1 | ,696 | ,725 | ,624 | ,628 | ,651 | ,525 | ,504 | ,422 | ,579 |
| 2. Manufacturing | | 1 | ,708 | ,712 | ,652 | ,621 | ,582 | ,639 | ,400 | ,538 |
| 3. Marketing & Sales | | | 1 | ,669 | ,731 | ,640 | ,547 | ,557 | ,428 | ,565 |
| 4. Information Systems | | | | 1 | ,681 | ,599 | ,532 | ,469 | ,309 | ,459 |
| 5. Logistics | | | | | 1 | ,767 | ,578 | ,543 | ,368 | ,520 |
| 6. External Relationship | | | | | | 1 | ,565 | ,552 | ,389 | ,539 |
| 7. Cost Leadership | | | | | | | 1 | ,764 | ,359 | ,464 |
| 8. Differentiation | | | | | | | | 1 | ,297 | ,481 |
| 9. Financial Performance | | | | | | | | | 1 | ,757 |
| 10. Growth Performance | | | | | | | | | | 1 |
| All correlation coefficients are significant at $p<0,001$ ($t_{min}$=5,506) | | | | | | | | | | |

**Test of the research model**

Based on the psychometric properties of the constructs, it was determined that the measures were sufficient and could be employed in hypothesis. First we evaluated the relationship between BCs and CSs. As it is shown in the Table-9 BCs and CSs are significantly ($p<0,001$; $t_{min}$=7,744) correlated each other. Thus Hypothesis1 was supported. Our result also proved Dess and Davis' (1994) finding, linkage between cost leadership to financial performance is stronger than differentiation to business performance.

Then we tested the linkage between BCs and business performance. After performing a regression analysis, we found management and marketing & sales capabilities have positive effect on financial performance. On the other hand management, marketing & sales, and external relationship capabilities have positive effects on growth business performance. Thus, Hypothesis 2 and 3 are partially supported. The regression results and the significance coefficients of H2 and H3 hypothesis can be shown on Table-6.

**Table-6: The Regression Results among Business Capabilities and Business Performance**

| Independent Variables | Financial Performance | | | | Growth Performance | | | |
|---|---|---|---|---|---|---|---|---|
| | *B* | *t* | p | Results | *B* | *t* | p | Results |
| Management | ,164 | 2,587 | ,010 | **H2a is supported** | ,237 | 4,034 | ,000 | **H3a is supported** |
| Manufacturing | ,125 | 1,951 | ,052 | H2b is not supported | ,112 | 1,890 | ,059 | H3b is not supported |
| Marketing and Sales | ,172 | 2,657 | ,008 | **H2c is supported** | ,166 | 2,766 | ,006 | **H3c is supported** |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Information Systems | -,055 | -0,890 | ,374 | H2d is not supported | ,006 | 0,113 | ,910 | H3d is not supported |
| Logistics | ,045 | 0,682 | ,496 | H2e is not supported | ,046 | 0,742 | ,459 | H3e is not supported |
| External Relationship | ,098 | 1,558 | ,120 | H2f is not supported | ,119 | 2,046 | ,041 | **H3f is supported** |
| | F=20,920 (p=0,000), $R^2$= 22,3% | | | | F=36,726 (p=0,000), $R^2$= 33,5% | | | |

Then we tested the linkages between CSs and business performance. We found that cost leadership strategy has positive effect on financial performance. On the other hand both CSs have positive effects on growth performance. The results of H4 and H5 hypothesis can be shown on Table-7.

**Table-7: The Regression Results among Generic Strategies and Business Performance**

| **Independent Variables** | **Financial Performance** | | | | **Growth Performance** | | | |
|---|---|---|---|---|---|---|---|---|
| | ***B*** | ***t*** | **p** | **Results** | ***B*** | ***t*** | **p** | **Results** |
| Cost Leadership Strategy | ,279*** | 4,360 | ,000 | **H4a supported** | ,218*** | 3,576 | ,000 | **H5a Supported** |
| Differentiation Strategy | ,094 | 1,468 | ,143 | H4b not supported | ,271*** | 4,451 | ,000 | **H5b supported** |
| | F=31,419 (p=0,000), $R^2$= 12,4% | | | | F=57,420 (p=0,000), $R^2$= 20,6% | | | |

Even all the relationships between independent and dependent variables were significantly correlated to each other, we found that some independent variables have no significant direct effect on business performance. These findings showed us some business capabilities have distinctive effects on business performance. Thus we took consider these distinctive capabilities while we were analyzing the mediating effects of BCs between CSs and business performance, which expressed in the hypothesis 6.

First we conducted a regression model based on the methodology of Baron and Kenny (1986) to analysis the mediating effects of these distinctive capabilities. This regression model included management and marketing & sales capabilities, cost leadership strategy, and financial performance. External relationship capabilities didn't consider while analyzing the mediating effects between cost leadership strategies and financial performance, because of it has no direct effect on financial performance. The results of the regression analysis in the Table-8 showed us the effects of cost leadership strategy on business financial performance partially reduced by the mediating effects of management, and marketing & sales capabilities.

**Table-8: The Total Effects of Cost Leadership Strategy, Management and Marketing & Sales Capabilities on Financial Performance**

| | **Model 1** | | | **Model 2** | | | **Model 3** | | |
|---|---|---|---|---|---|---|---|---|---|
| | ***B*** | ***t*** | **p** | ***B*** | ***t*** | **p** | ***B*** | ***t*** | **p** |
| Cost Leadership Strategy | ,347*** | 7,780 | **,000** | ,191*** | 3,911 | **,000** | ,187*** | 3,787 | **,000** |
| Management | | | | ,317*** | 6,491 | **,000** | | | |
| Marketing and Sales | | | | | | | 320*** | 6,489 | **,000** |
| | F=60,521 (p=0,000) $R^2$= 12% | | | F=54,141 (p=0,000) $R^2$= 19,7% | | | F=54,124 (p=0,000) $R^2$= 19,1% | | |

According to the results of the regression analysis, the mediating effects of both management and marketing & sales capabilities between cost leadership strategy and financial performance are depicted on the Figure-2.

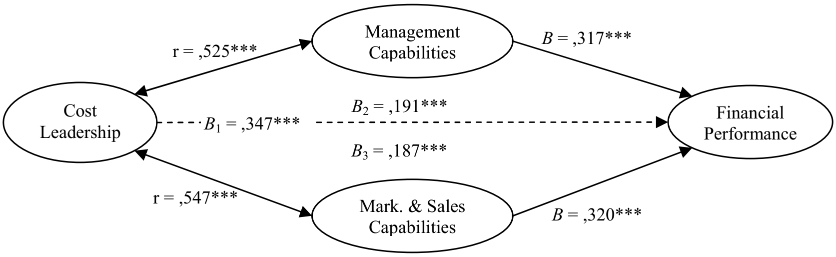



**Figure-2: The Mediating Effects of Management and Marketing & Sales Capabilities between Cost Leadership Strategy and Financial Performance**

Secondly we conducted a regression model included management, marketing & sales and external relationship capabilities, cost leadership strategy, and growth performance. With this regression analysis we investigated the total effects of cost leadership and distinctive BCs. The results of the regression analysis in the Table-9 showed us the effects of cost leadership strategy on growth performance partially reduced by the mediating effects of management, marketing & sales and external relationship capabilities.

**Table-9: The Total Effects of Cost Leadership Strategy, Management, Marketing & Sales and External Relationship Capabilities on Growth Performance**

| | Model 4 | | | Model 5 | | | Model 6 | | | Model 7 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *B* | *t* | p | *B* | *t* | P | *B* | *t* | p | *B* | *t* | p |
| Cost Leadership Strategy | ,413 | 9,548 | **,000** | ,209 | 4,583 | **,000** | ,220 | 4,728 | **,000** | ,239 | 4,945 | **,000** |
| Management | | | | ,417 | 9,156 | **,000** | | | | | | |
| Marketing and Sales | | | | | | | ,385 | 8,263 | **,000** | | | |
| External Relationship | | | | | | | | | | ,331 | 6,831 | **,000** |
| | F=91,156 (p=0,000) $R^2$= 17,1% | | | F=96,017 (p=0,000) $R^2$= 30,3% | | | F=86,643 (p=0,000) $R^2$= 28,2% | | | F=73,604 (p=0,000) $R^2$= 25% | | |

According to the results of the regression analysis, the mediating effects management, marketing & sales and external relationship capabilities between cost leadership strategy and growth performance are shown on the Figure-3.

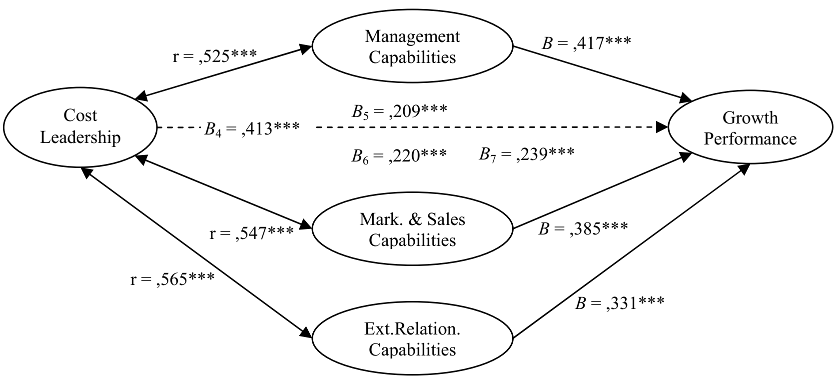



**Figure-3: The Mediating Effects of Management, Marketing & Sales and External Relationship Capabilities between Cost Leadership Strategy and Growth Performance**

Finally, we conducted a regression model among management, marketing & sales and external relationship capabilities, differentiation strategy, and growth performance (see Table 10). The results of the regression analysis showed us the effect of the differentiation strategy on growth performance partially reduced by the mediating effects of the management, marketing & sales and external relationship capabilities.

**Table-10: The Effects of Differentiation Strategy and BCs on Growth Performance**

| | Model 8 | | | Model 9 | | | Model 10 | | | Model 11 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | ***B*** | ***t*** | **p** | ***B*** | ***t*** | **P** | ***B*** | ***t*** | **p** | ***B*** | ***t*** | **p** |
| Differentiation | ,428 | 9,970 | **,000** | ,231 | 5,123 | **,000** | ,234 | 4,972 | **,000** | ,262 | 5,473 | **,000** |
| Management | | | | ,408 | 9,038 | **,000** | | | | | | |
| Market. & Sales | | | | | | | ,374 | 7,942 | **,000** | | | |
| Ext.Relationship | | | | | | | | | | ,321 | 6,701 | **,000** |
| | F=99,405 (p=0,000) $R^2$= 18,3% | | | F=99,601 (p=0,000) $R^2$= 31,1% | | | F=88,208 (p=0,000) $R^2$= 28,5% | | | F=77,081 (p=0,000) $R^2$= 25,9% | | |

According to the results of the regression analysis the mediating effects management, marketing & sales and external relationship capabilities between differentiation strategy and growth performance are shown on the Figure-4.

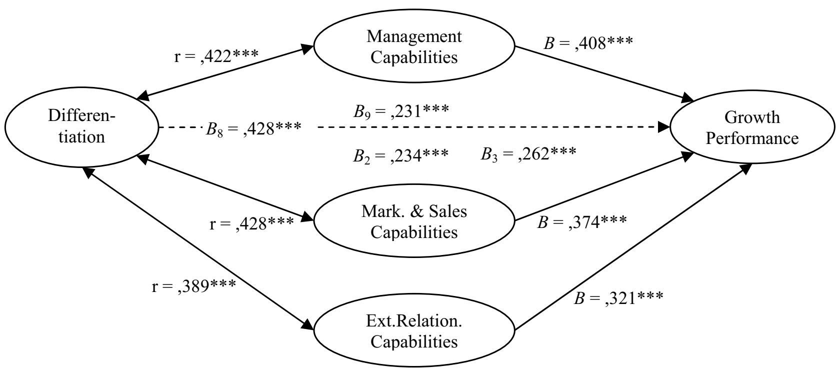



**Figure-4: The Mediating Effects of Management, Marketing & Sales and External Relationship Capabilities between Differentiation Strategy and Growth Performance**

# RESULTS AND DISCUSSION

According to the theory of RBV, capabilities defined as a bundle of skills and the knowledge that is strategically important to manage assets and coordinated activities effectively (Rumelt, 1984; Wernerfelt, 1984; Barney, 1991; Hall, 1993; Day, 1994; Helfat & Peteraf, 2003). These capabilities show us the dynamism of a firm's pool of resources (Amit & Schoemaker, 1993; Teece *et al.*, 1997). These firm specific capabilities which are learned through repetition are usually difficult for competitors to imitate (Dierickx & Cool, 1989; Grant, 1991) and firms differ based on their capabilities (Hitt & Ireland, 1986; Dierickx & Cool, 1989; Barney, 1991; Peteraf, 1993). Additionally, the ability to develop valuable, rare, inimitable and un-substitutable capabilities is the firms' main source of competitive advantage and performance (Hall, 1993; Teece, Pisano & Shuen, 1997; DeSarbo, et al., 2006). For this reason, the firm should diversify its capabilities and deploy them strategically – leading to greater efficiency and higher performance. In this context, we performed a questionnaire survey on manufacturing firms to prove these expectations through a hypothesized research model.

According to the analysis, we found that cost leadership strategies have directly positive effects on both financial and growth performance of the business. Thus, we could say that cost leadership strategy seems to lead to good firm performance. On the other hand differentiation strategy has some more direct efficiency on the business performance than cost leadership strategy while seeking a growth performance for a firm.

Contrary we could find no direct effect of differentiation strategy on financial performance. These findings should be appeared because of the grooving need of financial expenditures while differentiating the business' products and activities.

The results of the regression analysis which tested the total effects of BCs and CSs on business performance are nearly same with the analysis of the linkages between these independent variables on business performance independently. Even all the relationships between independent and dependent variables were significantly linked to each other; we found that some independent variables have no significant direct effect on business performance. These findings showed us some capabilities have distinctive effects on business performance, those were management, marketing & sales and external relationship capabilities. According to the analysis we could say that management and marketing & sales capabilities are the critical resourced based BCs which lead to good firm performance. Additionally external relationship capabilities can be considered among the distinctive BCs while expecting a successful growth.

To this end, we can suggest to the managers of the businesses to develop their managerial, marketing, sales capabilities in every situation initially. These capabilities will serve them while they leading their firms to better financial and growth performance than their competitors. Additionally they will need the external relation capabilities for a good growth expectation. We can suggest them, to accumulate a relationship portfolio among their customers, suppliers, and even their competitors.

On the strategic point of view we can say that, depending to the research findings, cost leadership strategy is the unique strategy to achieve better financial performance than the competitors. But while they seek good growth performance, we can suggest to perform differentiation strategy before and also more than cost leadership strategy.

# REFERENCES


Amit, R. and Schoemaker, P.J.H. (1993) Strategic assets and organizational rents. *Strategic Management Journal*, 14, 33-46.

Barney, J.B. (1986) Strategic factor markets: expectations, luck, and business strategy. *Management Science* 32, 1231-1241.

Barney, J.B. (1991) Firm resources and sustained competitive advantage. *Journal of Management,* 17 (1), 99 -120.

Baron, R.M. and Kenny, D.A. (1986). The moderator-mediator variable distinction in social psychological research: Conceptual, strategic and statistical considerations. *Journal of Personality and Social Psychology,* 51, 1173-1182.

Brislin, R. W. (1970) Back-translation for cross-cultural research. *Journal of Cross-Cultural Psychology*, 1, 185-216.

Celuch, K.G., Kasouf, C.J. and Peruvemba, V. (2002) The effects of perceived market and learning orientation on assessed organizational capabilities. *Industrial Marketing Management*, 31, 545-54.

Churchill, G.A. (1979) A paradigm for developing better measures of marketing constructs. *Journal of Marketing Research*, 16 (February), 64-73.

Day, G.S. (1994) The capabilities of market-driven organizations. *Journal of Marketing*, 58, 37-52.

DeSaa-Perez, P. and Garcia-Falcon, J.M. (2002) A resource-based view of human resource management and organizational capabilities development. *International Journal of Human Resource Management*, 13 (1), 123-40.

DeSarbo, S.W., DiBenedetto, C.A., Jedidi, K. and Song, M. (2006) Identifying sources of heterogenity for emprically deriving strategic types: A constrained finite-mixture structural-equation methodology. *Management Science*, 52 (6), 909-24.

Dess, G.G. and Davis, P.S. (1984) Porter's generic strategies as determinants of strategic group membership and organizational performance. *Academy of Management Journal*, 27 (3), 467 – 88.

Droge, C., Vickery, S. and Markland, R.E. (1994) Sources and outcomes of competitive advantage: An exploratory study in the furniture industry. *Decision Sciences,* 25 (5/6, Sep.-Dec.), 669–89.

Hall, R. (1993) A framework linking intangible resources and capabilities to sustainable competitive advantage. *Strategic Management Journal*, 14 (8), 607-18.

Helfat, C.E. and Peteraf, M.A. (2003) The dynamic resource-based view: Capability lifecycles. *Strategic Management Journal*, 24, 997–1010.

Hitt, M.A. and Ireland, R.D. (1986) Relationships among corporate level distinctive competencies, diversification strategy, corporate structure and performance. *Journal of Management Studies*, 23, 401-16.

Kaleka, A. (2002) Resources and capabilities driving competitive advantage in export markets: Guidelines for industrial exporters. *Industrial Market Management*, 31, 273–83.
Lado, A.A. and Wilson, M.C. (1994) Human resource systems and sustained competitive advantage: A competency-based perspective. *Academy of Management Review*, 19, 699-727.
Miller, D. (1986) Configurations of strategy and structure: Towards a synthesis. *Strategic Management Journal*, 7 (3), 233 – 49.
Miles, R.E. and Snow, C.C. (1978) *Organizational Strategy. Structure and Process* New York: McGraw Hill
Morash, E.A., Droge, C.L.M., and Vickery, S.K. (1996) Strategic logistics capabilities for competitive advantage and firm success. *Journal of Business Logistics,* 17 (1), 1-22.
Penrose, E. G. (1959). *The Theory of the Growth of the Firm.* New York: Wiley.
Porter, M.E. (1980) *Competitive Strategies*, New York: The Free Press
Porter, M.E. (1985) *Competitive Advantage-Creating and Sustaining Superior Performance*, New York: The Free Press
Porter, M.E. (1996) What is Strategy? *Harvard Business Review*, 74 (Nov.-Dec.), 61-78.
Ray, G., Barney, J.B. and Muhanna, W.A. (2004) Capabilities, business processes, and competitive advantage: Choosing the dependent variable in empirical tests of the resource-based view. *Strategic Management Journal*, 25, 23-37.
Stalk, G., Evans, P. and Shulman, L.E. (1992) Competing on capabilities: The new rules of corporate strategy. *Harvard Business Review*, 70, 57-69.
Teece, D.J. (2007) Explicating dynamic capabilities: The nature and microfoundation of (sustainable) enterprise performance. *Strategic Management Journal*, 28, 1319-50.
Teece, D.J., Pisano, G. and Shuen, A. (1997) Dynamic capabilities and strategic management. *Strategic Management Journal* 18 (7): 509-33.
Ulrich, D. (1987) Organizational capability as a competitive advantage: Human resource professionals as strategic partners. *Human Resource Planning*, 10 (4), 169–84.
Ulrich, D. (1989) Gaining strategic and organizational capability in a turbulent business environment. *The Academy of Management Executive*, 3 (2), 115-22.
Ulrich, D. and Lake, D. (1991) Organizational capability, creating competitive advantage. *Academy of Management Executive*, 5 (1), 77-92.
Ulrich, D. and Smallwood, N. (2004) Capitalizing on capabilities. *Harvard Business Review*, 82, 119-27.
Vorhies, D.W. and Morgan, N.A. (2005) Benchmarking marketing capabilities for sustainable competitive advantage. *Journal of Marketing*, 69, 80-94.
Wernerfelt, B. (1984) A resource-based view of the firm. *Strategic Management Journal*, 5 (2), 171-80.

# STRATEGIC CONCERNS OF COMPETENCE-BASED RISK PERCEPTION IN SERVICE PROJECTS

**Zoltán Veres**
**Budapest Business School, Hungary**
**University of Szeged, Hungary**

## ABSTRACT

*In strategic management when assessing company resources and competitive capabilities among intangible resources competence is a critical component. This research focuses on how intangible assets create customer value and strategic strength in service projects by decreasing perceived risk. Due to uniqueness and complexity of the transaction the expectation of project's actor is a problem-solving competence. The methodology of this research is fourfold. First, qualitative minifocus group discussions will be conducted at actors of project market. Second, an online survey will be simultaneously conducted in four countries to quantify the impact of the market based-assets on risk, value, loyalty and financial performance. In the third phase the quantitative results will be finetuned and validated by series of a postquestionnaire expert interviews. Fourth, a cross-country comparison will be made. We began our empirical research with expert mini focus group discussions conducted in the consultancy, the market research and the construction projects' market. In the paper some first findings are also presented. This research will help understand the risk perception of buyers, which can provide a proactive tool for the provider to devise effective risk management/communication strategies. In a strategic management dimension the expected results can enrich our knowledge on competitive capabilities of firms.*

## INTRODUCTION

There are several reasons why companies of the project industry succeed (Cova and Holstius, 1993), such as financial arrangements, entrepreneurial culture and reputation (Cova and Salle, 2007). Although the general process of projects and their pricing, in the case of tenders, are well-established in the project management and economics literature, it is not clear why some suppliers are better at closing a deal and successfully finishing a project with a project buyer, than others. According to our hypothesis the answer can be found to some extent in the competence of the actors.

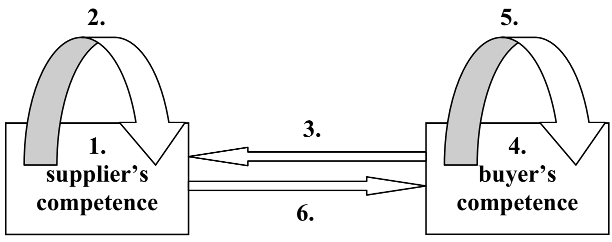
In strategic management when assessing company resources and competitive capabilities among intangible resources competence is a critical component. Competence can be interpreted in a simple, narrow approach as a product of technical experience and in a broader sense as a buildup over time of a versatile proficiency. "In business life, knowledge can be best described with the notion of competence." (Sveiby 1997:96)

The different types of competences manifesting themselves in a service can be grouped as follows (see Figure 1):

1. *Supplier's "real" competence*: competence, based on the "joint agreement of the industry", necessary for providing a service.
2. *Supplier's presumed competence relative to the service:* a subjective judgment on a supplier's own servicing competence.
3. *Supplier's "judgment" on a buyer's competence.*
4. *Buyer's knowledge ("lay competence") about the service technology.*
5. *Buyer's "opinion" of his or her own competence concerning the service*
6. *The "opinion or judgment" of the buyer of a service about the competence of the provider of that service (marketing dimension).*

We understand competence as a resultant of skills (epistemic competence) and capabilities (heuristic competence) serving for solution of the partner company's problems. By this definition epistemic competence is necessary as an evidence for the supplier on successful performance in the past, while the function of heuristic competence is to inspire confidence in the buyer that – for lack of relevant references – the supplier is capable to cope with the total system-like solution.

***Figure No. 1.*** *Competences in the supplier-buyer diad*




*Source: Veres 2007*

A supplier's competence is confronted with the competence a buyer presumes and then perceives about a supplier in a given transaction as well as with a buyer's own competence (presumed knowledge). In the project business actors can be considered as more or less (competent) experts of the technology and buyers are active participants of the transfer. The masters of competence (the experts) are key actors of knowledge organizations. The extension of competence to buyer's side can be explained even by this buyers' activity. (Cova and Salle, 1999, Bettencourt et al., 2002, Axelsson and Wynstra, 2002). The competence image consciously improved by the supplier is the basis of presumed competence. On corporate level competence means the firm's capacity to coordinate the flow of its knowledge and technology (Awuah 2001, Hamel and Prahalad 1994). The corporate competence is hierarchical (Banerjee 2003) and self-developing (Conceição and Heitor 2002).

Research conducted by Karl Erik Sveiby (1997) has largely contributed to understanding the competence of business market actors. According to its conceptual framework, the most valuable components of a company's immaterial assets (i.e. intangible resources) include:

- Brand
- Client relationship
- Competence

The latter is defined as "the capability of actors to act in various situations". Note his findings concerning the project market: "The ultimate (immaterial) asset of a construction company is its ability to execute complex projects... The major value … of consultancy firms lies in the competence of its personnel and their relationship with clients. (Sveiby 1997:68.)" Relying on the interrelationship between competence and the client relationship, suppliers must seek to establish stronger links with clients in order to maximally utilize immaterial resources.

# RESEARCH PROBLEM

This research investigates the role of intangible resources that aim at reducing the buyer's perceived risk, enhancing his value and satisfaction, and thus lead to the acceptance of the provider's offer and the success of the project. This research focuses on how intangible assets create customer value and strategic strength in service projects by decreasing perceived risk. These intangible resources are proposed to have a significant impact on the company's shareholder value, by accelerating, enhancing the provider's cash-flow and reducing its volatility (Srivastava et al., 1998; 2001). This research differs from the studies in the project management field as it only considers projects that entail buyer-seller interaction. The research is interdisciplinary as it relates to the area of project management, strategic management (competitive capabilities of firms), human resource management (intellectual resources), marketing (customer, channel and network relationships), sales management and finance (shareholder value) creation.

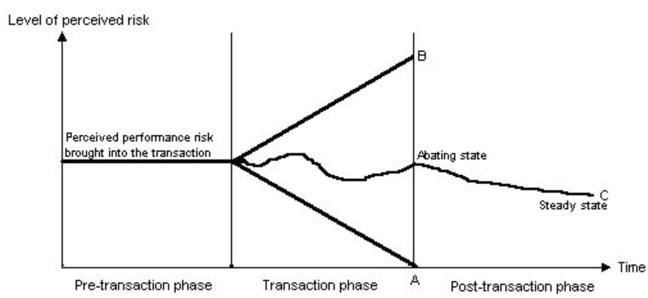
# PERFORMANCE RISK IN THE PROJECT MARKET

Project marketing is a new research area (Cova and Salle, 2007) especially in the service context. The project is dominantly a service, and from the point of view of service technology, the perceived risk connected to attaining a result is a competence-related risk (Van der Valk - Johnston, 2006). Due to uniqueness and complexity of the transaction the expectation of project's buyer is - first of all – a problem-solving competence.

By our definition, performance risk derives from goals. Bettman (1973) distinguished between inherent and handled risks. The latter is said to be the target area of managed risk. With particular projects, the goal is so complex that performance-related risks are very high as well. This tremendously increases the risk area (range between maximum and minimum risk) during the transaction process and it can last as long as the completion of the project.

What does this mean for actors of the project market? First, let us define project market where the object of exchange is a *task, limited both in terms of time and resources, which is performed by an ad hoc team*. This definition can cover any project-like activity, i.e. in addition to construction industry, it may include development consultancy, ad hoc market research, campaign management etc. Running a project has several characteristics which perceived risks can be derived from. In the pretransaction phase the main source of risk perception was defined by Ford (2002) as a sort of market uncertainty (Whom to buy from?). It can be called as a *partner choice* decision problem preceded by a so-called *consideration* phase. The latter is the first phase of the partner selection process and the former is the decision closing the selection process. The criteria of partner selection have been explored by Wuyts et al. (2009) in the field of ad hoc market research. It was found that in addition to the 5 positive relationship factors (good personal relationship, strong brand name, other clients' recommendations, service offering with advice and the expert image), price can be identified as a negative relationship factor. As a matter of fact, it can be demonstrated that there are two direct determinants at play in project transactions: the "subjective nature of the service solution" (i.e. uniqueness) and the strategic importance of the service solution. In sum, management of pretransactional perceived risk (uncertainty) needs an intensive communication from the actors.

***Figure No. 2 .*** *The risk perception funnel for services*




*Source: Veres 2009*

Continuing the analysis of this phenomenon, it must be identified that the risk perception scope of service transactions is not closed as the transaction is begun. Perceived risk is evoked by the danger of losing control over events that could have negative consequence. Risk perception is affected by how much buyers/suppliers think that they are able to mobilize their skills and knowledge when faced with such danger. Our key problem can be best understood from the trap found in the service process. Specifically, the perceived risk that a client feels in connection with the purchase is high (there is no "product sample") and it remains so during usage as well. Performance risk of user and provider of a service is perceptible in the phase prior to and during the entire process of the transaction and remains "at work" in the phase following the purchase as well. This latter is already a risk that is "projected back" onto the transaction that might strengthen the developing relationship between a buyer and a service provider, or on the contrary, it may justify a buyer's uncertainty felt before the transaction (see the problem of uncertainty at Ford, 2002, Van der Valk and Johnston, 2006 and Brashers 2001). This is because the success of a service transaction is uncertain until it is completed. And it is so for the provider of the service, too. That is what is meant by bilateral risk (see Van der Valk and Johnston, 2006). Taking an example, towards the end of the construction of an industry plant uncertainty of actors increases more and more, dramatically even. Namely, whether technology works properly can only be judged during the test run, while almost the entire hardware has already been built in untransferably. To understand the risk perceived by actors in a transaction, let us illustrate it in a funnel shape, as seen in Figure 2,

where
A: Ideal case: in the service process the risk perceived drops to nearly zero.
B: Unwanted result: in the service process the perceived risk increases dramatically.
C: The ordinary value of perceived risk is probably fluctuating in a range between A and B's boundary line but is subject to change even in the post-transaction phase until it stabilizes in the end.

From the above argumentation it can be seen that risk-reducing communication has to be based upon a continuous, phase-specific and clear message on problem solving competence of both sides. And the risk communication has to focus equally on the technology transfer (i.e. functional) and the cooperative (i.e. relational) competences.

# RESEARCH OBJECTIVES

The specific objectives of our research proposal are as follows:
1) Identification of the project phases and ways in which intangible intellectual and relational assets are employed in projects.
2) Identification of the impact of the intellectual and relational assets on value creation and risk perception, and thus, the success of the project.
3) Identification of the differences in perspective between the project buyer and supplier when applying these assets and between the negotiation and the implementation phase.

Srivastava et al. (1998) coined the term market-based assets in response to the need for facilitating the application of the resource-based view (Barney 1991) in the field of marketing. Market-based assets represent intangible assets, such as relational assets (external relationships) and intellectual assets (knowledge) that are rare, hard for competitors to imitate and substitute, and hence, significantly contribute to the provider's customer and financial performance.

Projects can take a variety of forms, and they are usually characterised as being complex, unique, interactive and discontinuous (Mandjak and Veres 1998). Project is a finite piece of work/solution with a time and budget constraint on an ad-hoc basis that have a provider and a buyer (external to the provider's organisation). As a result of these characteristics, risk is perceived on both the provider and the buyer side during the entire period of the project, hence identifying and managing this risk on both sides is of key importance for value to be created. Therefore, the research aims to primarily investigate the impact of knowledge and relationships on the buyer's perceived risk and further, explore how risk can be effectively managed in different phases in order to enhance the buyer's value perception and improve the provider's financial performance.

Sveiby defines expert competency classes in two different ways: first, based on the level of responsibility, he distinguishes managers dealing with one part of a project, others managing an entire project (i.e. project managers) and account managers who are fully responsible for a client. In his second approach, he distinguishes touts who make contacts and attract new clients, the overseers who are experienced advisors of the project supplier, and the processors who perform operative jobs. Our research is expected to clear up how management roles in the presales, sales and sustain phases of projects are fulfilled.

## Research questions

Our specific research questions are the following:

RQ1. What role do intellectual market-based assets, such as perceived competence (knowledge embedded in individuals and processes) play from a buyer's point of view when making the decision on cooperation? How is this knowledge communicated by the provider and perceived by the buyer in the individual stages of a project?

RQ2. What role do relational market-based assets, such as customer, channel and network relationships play from a buyer's point of view when making the decision on cooperation? How are these relational assets communicated by the provider and perceived by the buyer in the individual stages of a project?

RQ3. How do intellectual and relational assets jointly influence the risk/value perception of the buyer?

RQ4. What types of risks do market-based assets have an impact on in various stages of the project?

RQ5. How does risk management contribute to the buyer's value perception?

# METHODOLOGY

While recruiting study sample our starting point was that the differentia specifica of a project is the unique task under time constraint, i.e. it is independent of its industry. Therefore instead of reducing the project market to construction or high-tech industries projects as usual, we have extended it to other projects that have smaller hardware content.

With the objective of discovering the importance and influence of some non-tangible resources (namely the relational and the intellectual resources) on the perceived risk, satisfaction, intent of repurchase and loyalty of the buyers and sellers of service projects in four different countries (Hungary, New Zealand, USA and England), a cross cultural research is launched.

The methodology of this research is fourfold. First, qualitative minifocus group discussions will be conducted at actors of project market in the four countries to uncover the types of risk perceived by project buyers, the relevance and application of market-based assets and the risk management techniques of providers. Second, after having drawn a comprehensive picture of these elements, as well as identified and validated the scales and open questions of the questionnaire, an online survey will be simultaneously conducted in the four countries to quantify the impact of the market based-assets on risk, value, loyalty and financial performance. This research will focus on companies from various industries, such as construction, machinery, engineering, market research, advertising, consulting, and hence aims to make the results of the research more generalisable. In the third phase - in order to cross-check the results of the survey - the quantitative results will be finetuned and validated by series of a postquestionnaire expert interviews performed separately with buyers and sellers. Fourth, after the survey and the in-depth interviews are performed in the four countries, a cross-country comparison will be made. In the focus of the comparative studies there are three questions: a) what is the influence of the different macroeconomic background on the buyers' and sellers' evaluation of the analysed intangible resources, b) do the buyers evaluate international / multinational and domestic service project providers differently according to the relational and intellectual dimensions in the four countries?, c) do international / multinational buyers include different relational and intellectual resources into their evaluation of a seller than domestic ones in the four countries?

## Expert mini-FGD guideline

The phenomena under consideration are explored using the following focus group scenario. For the application of the method, we have chosen to lead discussion participants through a series of 8 statements to explore the content of competence-based risk perception. Concerning respondents' profile we aim at recruiting different decision makers in the project management process.

Statement 1: It is the most characteristic feature of a project that to some extent it is always unique and system-like.

Statement 2: The major benefit of the "product" for a customer is the supplier's ability to solve problems, i.e. this is a service.
Statement 3: The project process is a path that both parties are forced to take, because the success of performance can only be identified after the process has closed (hence the dominance of performance risk).
Statement 4: Perceived risk is reduced by presumed competence (intellectual asset). As a rule, this competence is asymmetric.
Statement 5: Communication of risk may reduce the uncertainties felt by the customer, but reduced uncertainty may reinforce risk perception.
Statement 6: Risk communication is different in the different management roles.
Statement 7: As confidence strengthens, long supplier-buyer relationship reduces the risks perceived, but the yield of relationship investments is doubtful due to discontinuity.
Statement 8: The value of the relationship is relative, thus relationship and transaction orientation is equally typical in the market.

## Time schedule

The first module of the research project is going to be completed in the first third of this year. The second, survey module, depending on the analysis of the first module's results, in late spring while the third one this summer. The cross cultural analysis is to be finished in autumn 2009.

# FIRST FINDINGS

We began our empirical research with expert mini focus group discussions conducted in the consultancy, the market research and the construction projects' market. Applying the FGD guideline, we may conclude the following as first findings.

Statement 1: It is the most characteristic feature of a project that to some extent it is always unique and systematic.

Uniqueness makes selling more difficult...

*Project selling does not involve selling a specific thing, but rather something that will be created in the future; it must be proved to a client that we are capable of implementing that particular thing and allowing the client to become more efficient and save money.*

... although the client side is becoming smarter. A project has a professional dimension and a methodological dimension. The methodological dimension is constantly the same, since the tasks of identifying, summarizing of needs, planning, and testing always repeat themselves.

*Whenever a need of a client arises... the best case is when we think up a solution together, and it is slightly worse when we do it alone, because ...* ***to the man who has a hammer, every problem looks like a nail****, i.e. those who are present when a problem is raised, try to handle a problem from their own point of view.*

The second feature (system-like) causes difficulties to the supplier, because there are new services that even the supplier lacks knowledge about, consequently this is a learning process for the supplier as well. Global knowledge flows within the company. There is a database that helps gain access to foreign experiences.

Statement 2: The core benefit of the "product" for a customer is the supplier's ability to solve problems, i.e. this is a service.

This is generally true, although sometimes the client also has well-trained people, in many cases, to solve our own business processes, but they cannot do one thing: assume responsibility, since they cannot influence actors within their own organization. In this respect, public and for-profit customers differ greatly. Those who have to stick to a budget have weak bargaining power.

Statement 3: The project process is a path that both parties are forced to take, because the success of performance can only be identified after the process has closed (hence the dominance of the performance risk).

When a project is interrupted, its end-product is basically destroyed. This is always the case with services which are real time products.

*...this is what we're trying to achieve. On each milestone, we restrict each other's possibilities more and more by prescribing what has to be implemented...If it's a very-very long project, there is a situational analysis and a diagnosis of needs, there is conceptual planning, then the concept, and all of these have to be accepted by both the client and the supplier, making this a common knowledge based on which to proceed.*

Statement 4: Perceived risk is reduced by presumed competence (intellectual asset). As a rule, this competence is asymmetric.

The client's professional competence might be higher in certain respects than that of the advisor's, whereas the advisor's system-related and empirical competence is much higher. These converge in the process, thus the client becomes familiar with the system and the advisor finds out about the general practices of the given company. This approximation of knowledge takes place in a managed process. The quality of the supplier's references makes a great difference, as this is a reference-based market.

Statement 5: Communication of risk may reduce the uncertainties felt by the client, but reduced uncertainty may reinforce risk perception.

The customer's risk is higher than just the money paid, because even his or her entire business might collapse.

*... it is more and more marketing-like that at the beginning of every project we usually inform the buyer of certain risk factors, just for the sake of self-defence.*

From this marketing perspective, risk communication helps the supplier. The buyer's risk perception changes during the sales cycle. First, the buyer is open to every option. As s/he becomes increasingly involved in the project, his/her sensitivity to functions gradually decreases, while risk sensitivity increases.

Statement 6: Risk communication is different in the different management roles.

The best, risk-preventive solution for that can be observed in the consulting business. This includes the practical execution of the roles in *project delivery management* which covers several projects simultaneously, *project management* which directs specific projects, *sales management* which is aimed at acquisition, *engagement management* dealing with contractual issues and in *customization management* which is responsible for fine-tuning a project from a customer-oriented perspective.

Statement 7: As confidence strengthens, long supplier-buyer relationship reduces the risks perceived, but the yield of relationship investments is doubtful due to discontinuity.

To allow the supplier to maintain the operation of his/her business, it is important to be at the client's place. This continuous relationship is institutionalized in so-called support contracts. This may support new contracts.

*...unless we have concluded such a contract, there is a cost of strengthening this relationship...*

... but its yield is uncertain.

Statement 8: The value of the relationship is relative, thus relationship and transaction orientation is equally typical in the market.

On the consultancy market, everybody considers themselves relationship-oriented. This results from the confidence character involved. However, a return on relationship (ROR) analysis is not typical, since relationship management is rather intuitive.

## PRACTICAL AND THEORETICAL CONCERNS

From a practitioner's point of view this research will help project providers understand and identify the combination of market-based assets that are perceived to enhance customer value and/or reduce the buyer's risk. Furthermore, this research will also help understand the risk perception of buyers, which can provide a proactive tool for the provider to devise effective risk management/communication strategies. Deeper understanding of role and content of actors' competence offers a new competitive tool in formulating strategic management plans.

From an academic point of view this research's contribution is that it focuses on an interactive value creation process in a unique setting (project) by cutting across functional silos and builds on the resource-based, network and transaction-cost theories. In a strategic management dimension the expected results can enrich our knowledge on competitive capabilities of firms.

## REFERENCES

Awuah, G.B. (2001), A firm's competence development through its network of exchange relationships, *Journal of Business and Industrial Marketing*, Vol. 16, No. 7, pp. 574-599.

Axelsson, B. and Wynstra, F. (2002), *Buying Business Services*, Wiley, Chichester

Banerjee, P. (2003), Resource dependence and core competence: insights from Indian software firms, *Technovation*, Vol. 23, pp. 641-651.

Barney, J. B., (1991), Firm Resources and Sustained Competitive Advantage. *Journal of Management*, 17(1), pp. 99-120.

Bettencourt, L.A., Brown, S.W., Ostrom, A.L. and Roundtree, R.I. (2002), Client Co-Production in Knowledge-Intensive Business Services, *California Management Review*, Vol 44, Summer, pp. 100-128

Bettman, J. (1973), Perceived Risk and Its Components: A Model and Empirical Test. *Journal of Marketing Research*, 10 (May), pp. 184-190.

Brashers, D. E. (2001), Communication and Uncertainty Management, *Journal of Communication*, Vol. 51, Issue 3, pp. 477-498.

Conceição, P. and Heitor, M.V. (2002), Knowledge interaction towards inclusive learning: Promoting systems of innovation and competence building, *Technological Forecasting & Social Change*, Vol. 69, pp. 641-651.

Cova, B. and Holstius, K., (1993), How to create competitive advantage in project business. *Journal of Marketing Management,* 9(2), pp. 105-121.

Cova, B. and Salle, R. (1999), *Le marketing d'Affaires*, Dunod, Paris

Cova, B., and Salle, R., (2007), Introduction to the IMM special issue on 'Project marketing and the marketing of solutions. A comprehensive approach to project marketing and the marketing solutions'. *Industrial Marketing Management,* 36(2), pp. 138-146.

Ford, D. (ed.) (2002), *The Business Marketing Course – Managing in Complex Networks*, Wiley, Chichester

Hamel, G. and Prahalad, C.K. (1994), *Competing for the Future*, Harvard Business School Press, Boston

Mandjak, T. and Veres, Z. (1998), The D-U-C Model and the Stages of Project Marketing Process, in: Halinen-Kaila, A. – Nummela, N. (eds.): *Visions for the future*, IMP Proceedings, Turku, Vol. 1, pp. 471-490.

Srivastava, R. K., Shervani, T. A. and Fahey, L., (1998), Market-base assets and shareholder value: A framework for analysis. *Journal of Marketing,* 62(1), pp. 2-18.

Srivastava, R. K., Fahey, L., and Christensen, H. K., (2001), The resource-based view and marketing: The role of market-based assets in gaining competitive advantage. *Journal of Management,* 27(6), pp. 777-802.

Sveiby, K.E., (1997), *The New Organizational Wealth*, Berrett-Koehler, San Francisco (CA)

Van der Valk, W. and Johnston, W. J., (2006), Purchasing Business Services - The Impact of Perceived Risk on Buyer-Seller Interaction, *Proceedings of the 22nd IMP Conference*, Milan

Veres, Z., ((2007), „A kockázat megmarad, csak az érzet változik" – Tranzakciós és kapcsolati preferenciák a projekttípusú üzleti szolgáltatások piacán (Transactional and relationship preferences in the market of project-type business services), *Vezetéstudomány*, 38 (9), pp. 51-64

Veres, Z., (2009), Competence-based risk perception in the project business. *Journal of Business & Industrial Marketing*, 24 (3/4), pp. 237-244

Wuyts, S., Verhoef, P. E., Prins, R., (2009), Partner selection in B2B information service markets. *International Journal of Research in Marketing,* 26, pp. 41-51

# A RESOURCE BASED ANALYSIS OF THE GROWTH OF THE YACHT BUILDING SECTOR AT ANTALYA FREE TRADE ZONE


**Fulya Sarvan, Eren Durmuş Arıcı, Tuğba Gürçaylılar Yenidoğan, Onur Dirlik**
**Akdeniz University, Turkey**



## ABSTRACT

*This study aims to answer the question whether the fast development of the yacht building sector at Antalya Free Trade Zone (FTZ) can be explained as an emergent collective strategy affected by the interplay of dynamic collective capabilities. The concepts and frameworks of the resource based view were jointly used with the concepts of emergent collective strategies pertinent for clusters in order to analyse the factors behind the evolution of the sector. The research questions were pursued through questionnaires and in depth interviews with the top level management of the major yacht building firms and the Free Trade Zone Administration. Observations and document analysis where possible supplemented the data collection process. The results of the study indicated that the foundation phase of the sector in the Zone can be described as an unintended agglomeration of yacht building firms, which fostered some dynamic capabilities like human capital, social capital and cognition that eventually gave rise to collective competitiveness.*



**Key words:** *Emergent collective strategies, clusters, resource-based view, dynamic collective capabilities, yacht building firm clusters, Antalya Free Trade Zone.*


## INTRODUCTION

In this study we aim to bring an explanation to the surprisingly fast growth of the yacht building sector at Antalya Free Trade Zone (FTZ), using the concepts of the resource based view (RBV) which over the last two decades has been promoted as a unifying theory of strategy and has emerged as a popular theoretical perspective for explaining performance (Crook et al., 2008). This theory seeks to bridge the gap between theories of organizational capabilities on the one hand and external competitive theories on the other (Maijoor and Witteloostuijn, 1996). Until 1990's the role of organizational resources and capabilities in providing competitive advantage was not given proper attention while the industry based positioning view developed by Porter (1980, 1985) dominated the area.

Resource based view, instead of analyzing competitive advantage in relation to industry structure, focuses on firm-specific resources. Penrose (1959), whose study originated the idea that a firm's strategic resources are important for competitiveness, defined a firm as a collection of productive resources and described how current resource stocks, along with opportunities to deploy them, limit the direction and speed of future growth. Similarly, Wernerfelt (1984) proposed that firms can be viewed as collections of resources and that these resources enable effective product market strategy. Following work elaborated on the specific criteria for resources and capabilities which would enable firms to generate and sustain competitive advantage and consequently high performance (Barney, 1986, 1991; Amit and Schoemaker, 1993; Collis and Montgomery, 1995; Peteraf, 1993; Grant, 1991). The RBV of the firm was also conceptually extended to the territory or cluster level by the works of a host of authors (Harrison, 1994; Enright, 1995; Foss, 1996; Lawson, 1999; Maskell and Malmberg, 1999) who developed the idea that territories could provide higher-order capabilities to the located firms, and that these contribute to explain a firm's internal capabilities.

Finding the resource based reasons and dynamics behind the emergence of the yacht building sector at Antalya FTZ is of interest, because it has performed as the fastest growing business of the Zone which is situated at Antalya Harbour, 12 km from town center and 25 km from the airport. The Zone has enjoyed a high growth rate during recent years and made considerable contribution to the Turkish economy. The total volume of trade realized by the Zone in 2008 has been $ 729 million (www.dtm.gov.tr, 2009). Out of the 107 companies operating in the Zone as of the year 2008, 47 are licenced as yacht building and related (yacht supplies and yacht services) companies, whereas their number was only 33 in 2006, 15 in 2004 and only 3 in 2000. Preliminary analysis of the industrial development of the Antalya FTZ revealed that developing a yacht building sector had not been the original purpose or intended strategy of the founders. The infrastructure of the Zone, planned and built at the outset is a powerful testimony for this statement. The roads and other service facilities were not designed to accomodate mega yacht building. Moreover, since its foundation in 1987, the Zone seems to have changed its strategic track at least three times before reaching the current state. Today, yacht building sector is unanimously indicated as the most promising sector, the composite mega yacht building capability ranking as the first in Turkey and the third in the world. Thus it seemed worthwhile to investigate in this current study to what extent the firm owned and/or later acquired resources and capabilities of the yacht building firms can be held accountable for this rapid growth and whether any resources provided by the Zone or the collective capabilities of an emerging cluster had any meaningful contribution to it.

Since these research questions need to be handled at various levels of analysis, including the interorganizational as well as the firm-level, implications of the cluster theory had to be taken into consideration. The cluster theory proposes that the immediate business environment outside companies plays a vital role as well as the inside of the company and that clusters promote both competition and cooperation. A cluster is defined by Porter (1990) as a geographical concentration of inter-related firms, specialized suppliers, knowledge producers and research centers, brokers, consultants and consumers, connected in a value producing chain. In his diamond model, Porter argues that geographic concentration magnifies the power of domestic rivalry. Close linkages with buyers, suppliers and other institutions are significant for productivity. This dynamic view of competition highlights the importance of location. Wilk & Fensterseifer (2003:996) assert that today in a world of alliances and coalitions, competition increasingly occurs between supply chains, networks of firms, or clusters, and this prompts the formation of clusters. There is empirical evidence that clusters promote productivity, innovation and competititon in a number of ways, i.e. the reduced cost of sharing resources, the critical mass created by having a pool of specialized skills, expertise and value added products (Singh, 2001:8). Clusters enhance economic foundations such as a skilled workforce, research and development capacity and infrastructure and create assets such as trust, synergy, collaboration and co-operation which are all essential for competitiveness. It is indicated by Porter (1998) that a cluster, consisting of independently and informally linked companies and institutions, offers advantages in efficiency, effectiveness and flexibility. The companies mutually supporting each other benefit from the backward, forward and vertical flow of cooperation.

There are a number of analytical techniques and measures to identify the existence and assess the success of clusters, like expert opinion, location quotient, cluster power index, network analysis, input output measures, surveys and Porter's diamond model (Singh, 2001:9). The present study will not attempt to identify the existence of a yacht building cluster at Antalya FTZ, but will assume that there is an emerging cluster of yacht building firms in order to be able to use the analytical concepts of the theory. Specific objectives of this study will be first to identify the strategic resources and capabilities of the yacht building sector and make an assessment of the extent to which they are available at Antalya FTZ. A second objective will be to track the historical development of the sector and identify the corresponding evolution of firm level and collective resources and capabilities in the Zone. Identification of the strategic resource positioning of firms will be the third objective of the study. Consequently the study aims to answer the question whether the development of the yacht building sector at Antalya FTZ can be explained as an emergent collective strategy affected by the interplay of dynamic collective capabilities. These research questions were pursued through questionnaires and in depth interviews with the top level management of the major yacht building firms and the FTZ Administration. Observations and document analysis where possible supplemented the data collection process.

## Emergent Collective Strategies and the Resource Based View

Consideration of the interorganizational and collective action among the emerging cluster of yacht building firms brought to the fore the concepts of *interorganizational ecology*, which is the study how similar and dissimilar populations that comprise *communities* interact with eachother and how they *collectively* adapt to the environment (Rao, 2002:541). The roots of *interorganizational cooperation* and the *theory of collective action* are found in the sociobiology of Hawley (1950) and exchange theory of Blau (1964) and Cook (1977). These were later developed into the resource dependence model (Aldrich, 1976; Pfeffer and Salancik, 1977). Based on these concepts collective strategy was conceptualized as attempts to overcome strategic weakness through interorganizational and collective activity (Dollinger, 1990:268).

A framework for the *co-actions* or *collective actions* of organizational communities was provided by the seminal work of Astley & Fombrun (1983). The authors used the concepts of *bioecology* [sociobiology] advanced by Hawley (1950) to analyse the *individual and communal adaptations* of organizations. Hawley (1950:209) asserted that collective adaptation is the distinctive subject matter of ecology and proposed c*ommensalism* and *symbiosis* as two types of communal adaptations. Symbiosis is "inter-dependence of unlike forms, i.e. units of dissimilar functions, and implies that populations occupying different niches benefit from eachother's presence (Rao, 2002: 541). Commensalism, on the other hand involves the "co-action of like forms, i.e. units of similar functions (Hawley, 1950:209), and entails potential competition between interacting populations, the degree of which depends on the degree of similarity or overlap of the niches they occupy (Rao, 2002:541). Hence, "a group of populations bound by ecological ties of *commensalism* and *symbiosis* that consequently coevolve with eachother and their environment" is named as *organizational community* (Rao, 2002:541).

Using the communal adaptation concepts developed by Hawley (1950), Astley & Fombrun (1983:580) proposed that *collective strategy* is "a systemic response by a set of organizations that collaborate in order to absorb the variation presented by their interorganizational environment". Two analytical dimensions of interdependence (commensalistic & symbiotic) and the nature of relation (direct & indirect) were employed by the authors to develop four ideal types of collective, named *agglomerate, confederate, conjugate,* and *organic.* Among these, the *agglomerate collective*, which is defined as "clusters of organizations of the same species that compete for a limited supply of similar resources" seems the most applicable to the yacht building firms in the FTZ. This form of collective involves indirect commensalism and information is the principal resource that flows through the network."It is the wide dissemination of information that keeps competition alive" (Astley & Fombrun,1983:581). The other ideal type applicable to the present study would be the *conjugate collective*, which is "comprised of organizations from different species whose interactions are directly or tightly coupled because of the complementary functions they perform for eachother". This type would include the yacht suppliers and service providers of the yacht building sector, which could not be covered in the present study.

In investigating the interorganizational actions of the agglomerate collective of yacht building firms, the *emergent strategy* concept advanced by Mintzberg and Waters (1985) was adopted, because preliminary analysis of the evolution of Antalya FTZ revealed that yacht building sector was not the original purpose or intended strategy of the founders. Emergent strategies are patterns or consistencies in firm behaviour in the absence of intentions, while deliberate strategies are the ones which are realized as intended (Mintzberg and Waters, 1985). Basing on these concepts Dollinger (1990:267) defined *emergent collective strategy* at the population level, as the "unintended result of aggregated repetitive patterns of pairwise interorganizational activity". This definition is closely related to the one provided by Bresser (1988:375) as, "attempts by sets of organizations to manage their mutual interdependence and the system dynamics of their interorganizational environment". Dollinger argues in his article that collective strategy is less visible in fragmented (meaning many loosely linked small-sized firms) industries, because much of this strategy is emergent in nature. One important implication of this argument is that, "a mechanism exists within a population of firms in a fragmented setting for initiating and transforming firm-level behaviour without a central organizing authority" (Dollinger, 1990:267).

As explained above, the ultimate objective of this study is to employ the concepts of the RBV in explaining the emergent collective performance of the yacht building sector at Antalya FTZ. This entails identification of the dynamic evolution of the firm level and collective resources and capabilities in the Zone. The cluster literature provides a host of ideas concerning the resources and capabilities available in industrial clusters (Wilk, 2003; Tallman et al., 2004; Dahl & Pedersen, 2004; Foss and Foss, 2005). Wilk (2003) draws attention to the bundle of resources of a region as a source of competitive advantage, which can be based on natural or artificial asymmetries, such as topographical, climatic, structural and cultural endowments. Tallman et al. (2004) develop a model of the stocks and flows of knowledge as critical sources of competitive advantage for clusters and the firms within them by integrating concepts from economic geography with those of strategic management. Dahl and Pedersen (2004) inquire the role of informal networks in the development of regional clusters to conclude that "informal contacts represent an important channel of knowledge diffusion". Foss and Foss (2005:554) propose that collective strategic resources created by the firms in a cluster lead to performance differences between clusters of the same industry, by reducing the searching costs in an industrial cluster.

Wilk (2003:7) proposed a typology of strategic resources of a cluster classified as *singular*, *systemic* and *constrained.* Singular resources are strategic resources at the firm level like "technological trajectory, familiar history, long-term contracts, co-specialication of assets, knowledge asymmetries or immobility conditions". Systemic resources are not owned by individual firms but are shared by all the firms in an industrial cluster. Unlike singular resources, they do not have an impact on the competition between firms of the cluster but they positively affect the efficiency differentials between clusters of firms. Formation of systemic resources is path dependent, following a complex and historical process. They may sometimes be derived from natural inheritance, such as the climatic topography, the soil, the culture and the social capital of a region which are marked essentially by their immobility. Resources can also be developed by governmental initiative like research and education institutions, logistics centers etc. Constrained resources do not belong to single firms, but they have access only by a restricted sub group of firms that adopt a certain type of behaviour or conduct in the industrial environment where they participate. This restricted access may be due to the firms' participation in the history of the cluster, advantages of geographic positioning or some other initiative of firms to gain a resource position and complementary knowledge. These resources give way to the formation of high performance strategic groups in an industry. In this model, Wilk (2003) defined *collective competitiveness* as a product of the interaction between competitive capabilities of all firms in the cluster. It is the result of not only systemic resources but also constrained and singular ones. While singular resources cause competitive differentials between firms in the cluster, systemic resources give rise to competitive differentials between clusters and constrained resources lead to competitive differentials between strategic groups in the cluster.

According to Wilk's (2003:4) model the singular, systemic and constrained resources of a cluster sustain competitive advantage in conditions of imperfect imitability, imperfect substitutability and imperfect mobility of a resource, which depend on a series of factors like causal ambiguity, asset complementarity and path dependence. *Causal ambiguity* exists when competitiors are unable to identify the valuable resources or the way to recreate them *A path dependence condition* means that a resource or asset was developed and accumulated in a process through time, generally in a process of learning by doing. There are two alternative ways for imperfect mobility. One is named *specialization,* meaning it is impossible to use the resource for another firm without a decrease in value. In the *co-specialization condition,* value can only be created through joint usage of the resource.

In relation to the competitive interactions among cluster firms, Tallman et al. (2004) examine the flow of informal knowledge sharing between firms and basing on the literature they distinguish between two types of knowledge, component and architectural, with special emphasis on their transferability. They propose that knowledge is more likely to be mobile when it becomes simpler, codified, less tacit and less path dependent. C*omponent knowledge* relates to identifiable elements such as scientific, technical, engineering, and design skills of an organizational system. A*rchitectural knowledge* relates to an organization as a whole and consists of organizational routines and schemas for coordinating and integrating the various components of the organization and putting them to productive use. Spillovers make component knowledge available to all members of the cluster. It provides short-term competitive advantage to the cluster as long as it remains within the cluster. Architectural knowledge establishes the rules of the game among the cluster members and develops as cluster members interact with eachother. This can provide sustainable competitive advantage to firms in the cluster by establishing a unique common base of knowledge for the application of technology and restricting the movement of component knowledge out of the cluster.

Dynamic resource based view was developed as a response to the criticisms regarding the static approach to resource assessment. Teece, Pisano and Shuen (1997:516) advanced the concept of dynamic RBV emphasizing the evolution of organizational capabilities. They defined *dynamic capabilities* as, "the firm's ability to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments". Basing on this, Helfat and Peteraf (2003) introduced the concept of *capability lifecycle* which provides a framework linking the evolution of capabilities over time with specific growth stages of a firm. The recognizable stages suggested are the *founding*, *development* and *maturity* stages similar to the product lifecycle. The capabilities critical for founding stage are the *human capital*, *social capital* and *cognition*, with general requirements of an organized group or team and a central objective. At the development stage, team develops capabilities by choosing either to imitate a capability that exists in another organization or to develop a capability from scratch. Finally the maturity stage entails capability maintenance. The founding and development stages of capability lifecycles were found suitable for analysing evolution of capabilities in the present study.

# The method of analysis

## Level of analysis

The level of analysis employed in this study required some methodological sophistication. Although individual firms have been the preferred unit of analysis in strategy literature, the research of the present study had to be conducted not only on the individual firms, but also on the cluster of firms, to be able to identify the contribution of resources and capabilities shared by the cluster as a whole. This is partly in line with the meso level of analysis followed by Hervas-Oliver and Albors-Garrigos (2007) in their analysis of ceramic tile clusters located in Spain and Italy. To avoid the "'ecological fallacy' of aggregating micro-units to obtain an average that represents the spatial context" (Cooke et al., 2005) the authors asked firm managers regional questions and their overall assessment about the cluster resources and capabilities instead of firm-level questions.

Similarly, Wilk (2003:5-6) makes a reference to Esser et al. (1996) who advanced the concept of s*ystemic competitiveness*, suggesting four levels of analysis (micro, meso, macro and meta) applicable not only to clusters but to the industries in general. This concept proposes that the competitiveness of a firm and of an industry are dependent not only on actions of individual firms but also on actions taken by many actors in each one of four levels. The meso analytical level is defined by questions on technology policies, industrial policies, regional policies and the institutional environment to support firms. The meta analytical level is defined as the qualifications of the actors and institutions in regional, national and supranational levels in creating favourable conditions for the industrial dynamism. The authors propose that the dynamic development of an industry is based in the collective efforts for the creation of a supportive environment to the development of the businesses and the meso and meta levels have to be considered besides the micro and the macro.

In relation to collective issues Felin and Foss (2006) take an alternative position that explanation must ultimately be grounded in explanatory mechanisms that involve *individual action* and *interaction*, that is *methodological individualism*. This involves a criticism of the fact that emphasis on collective constructs has lead to a corresponding neglect of the levels of individual action and interaction (Felin & Herterly, 2006; Felin & Foss, 2006). The answer to this neglect was found in the conceptual model of sociologist James Coleman (1990) which brings a unifying tool to capture meta-theoretical matters and problems relating to micro-macro relations. His framework provides a general model of social science explanation, making a distinction between the macro and the micro-level and the dependent variable (explanandum) and the independent variables (explanans), and showing the links between macro-macro, macro-micro, micro-micro and micro-macro with arrows indicating the direction of the explanation. The ultimate aim is to explain a macro-level phenomenon by making use of theoretical mechanisms implied by the arrows. This is called *mechanism-oriented approach* to social science explanation (Felin & Foss, 2006:10). For the purposes of the present study this framework is applicable by taking the collective strategy as the macro, and the individual firms as the micro level. Consequently, macro level research question of the present study was inquired by asking questions at the micro (firm-level), meso (policy and institutions assessment) and meta (regional and national actors) levels to the directors of the firms, the Zone Administration, the Zone Operating Company (ASBAŞ) and the Association of Yacht Building Companies at Antalya FTZ.

## Data collection method

Preliminary data about the population of yacht building firms licenced in the region was obtained from the Zone Administration, the Zone Operating Company (ASBAŞ) and from the web sites of the firms. Between September 2008 and April 2009, a series of semi-structured interviews were conducted with the directors of some of the yacht building firms, the Zone Administration, the Zone Operating Company (ASBAŞ) and the Association of Yacht Building Companies at FTZ. During the interviews a questionnaire containing questions about the resources and capabilities available to the firms in the Zone was also administered. The semi-structured in-depth interviews with the firm managers contained questions pertaining to the major incentives attracting them to the yacht building sector in the Zone, their perceptions regarding the fast growth of the sector, their operational and competitive strategies and what kind of firm based or collectively created resources or capabilities had played a crucial role in their competitive performance and the major advantages or disadvantages of operating in the Zone. The directors of the Zone Administration, the Zone Operating Company (ASBAŞ) and the Association of Yacht Building Companies at FTZ were inquired pertaining to the evolution of the industries in the Zone, the initiation and growth of the yacht building sector in the Zone, their policies and operations in support of the sector, the major drawbacks and problems related to this sector in the Zone. Each interview took 90 to 120 minutes; was tape recorded upon permission and transcribed after the interview session. The transcription texts and the selected documents were subjected to content analysis, first highlighting the important and pertinent information and then picking up the main themes, central ideas or important details. The original expressions of interviewed managers were conserved. The official yearly reports of the Zone Administration and ASBAŞ from 1992 to 2008, news, interviews and articles published in some popular yachting magazines and newspapers, some attained from the internet, publications about the Free Trade Zones in Turkey formed the data base for document analysis as a supplement to the above mentioned data collection.

## Sampling

Initial plan of the study was to reach a sufficiently representative sample from the whole population of 33 yacht building firms licenced in the FTZ. The 14 yacht supplies and services firms were not included in the study. Out of the 33 yacht building firms, only 22 were available, because 1 had recently quit business, 5 were in the phase of constructing shipyard, 3 were still in the preparatory stage for investment and 2 were taken over by other yacht building companies in the region. The procedure followed for selecting the firms for interview was judgemental sampling, meaning the researchers selected the firms to interview according to some predefined criteria. The oldest and the most promising newest firms in the Zone, and the ones with highest number of yacht sales were considered to be the important actors to get information about the different evolutionary stages of the Zone. In preparation for the firm-level interviews, preliminary interviews were conducted with the directors of the Zone Administration, the Zone Operating Company (ASBAŞ) and the Association of Zone Investors and also a previous director of ASBAŞ, who were all very informative about the historical evolution and the most important players at the firm-level in the Zone. Each interview took 120 minutes on the average and each gave an idea about the firms to be given priority for interview and about the concepts to be inquired in data collection. The request for an interview was directed to the management of the selected 11 firms and among these 8 firm managers accepted to make an interview and fill out the questionnaire. Each interview gave an idea about the next interview to be conducted and eventually 8 case stories were completed during the study. The interviewed people were generally informant managers responsible for the operations of the firm. Only one founding owner/manager participated in the interview. The final sample consisted of firms that had collectively manufactured 117 of the total 147 yachts (80%) sold from the region. This proportion represents an important portion of the yacht building experience accumulated in the region.

## Data collection tools

The semi-structured interview questions and a RBV questionnaire were the basic data collection tools of the study. Since there was no empirical study concerning the strategic resources and capabilities of the yacht building sector, these tools were based on the previous studies of the authors on the same sector, the information provided by informant actors of the Zone and also publications about the yacht building sector in general. The resultant questionnaire about the resource base of the sector consisted of three parts. The first part contained questions pertaining to the degree of importance attributed to a list of resources and capabilities for strategic advantage in the yacht building indutry, and the corresponding degree of attainment to it by the firm. The second part contained questions about the degree of importance attributed to a list of resources related to the regional location and the Zone administration, and the corresponding degree of provision by the Zone. And the third part asked for evaluation of whether ten important resources for the sector were available at the outset or were developed later.

## Data and Findings

Data collected via different methods during the study were compiled and analyzed to draw some general conclusions concerning the resource and capability based reasons behind the rapid growth of the yacht building sector in the region. The findings of the study are summarized below.

## The FTZs in Turkey and Antalya Free Trade Zone

An FTZ (some forms are called export processing zone -EPZ- or duty free trade zone) is a specially reserved area of a country where tariffs and quotas are eliminated and bureaucratic requirements are lowered in order to attract investments by raising the incentives for doing business there. The history of FTZs in Turkey dates back as far as 1927 but zones in the real sense of the word were established in the second half of 1980's. The Law of FTZs (no.3218) passed in 1985 and until now 20 zones were set up in different regions of the country. As of 31st December 2008, the number of licenced firms in these zones reached 3.619, 2.981 of which are domestic and 638 foreign. The total employment provided by these zones reached 50.641, total value added approximately 24.5 billion US dollars (wwww.dtm.gov.tr, 2009).

Antalya Free Trade Zone was put into service in 1987. The land and the finance for infrastructure investment was provided by the state and the infrastructure was constructed by investing companies. The operation of the Zone was given by the Decree of the Board of Ministers to a private company called ASBAŞ, 34% of whose capital belongs to the public and the rest is owned by private companies. The Zone has a well developed infrastructure with electricity, water, telecommunications and sewage purification systems, roads, green areas and since 1998 also possesses a quay where all sorts of loading and unloading can be done. The starting of container trade from Antalya Harbour since 2000 has improved the geographic advantages of the Zone. The capacity utilization rate of the Zone has recently reached 99% (www.ant-free-zone.org.tr, 2008).
The Zone originally served as the machine park of construction companies which won bids from the Mediterranean countries, but could not achieve real growth until 1995 due to successive economic crisis and the Gulf War (ASBAŞ, 2007). In 1994 there was an attempt by the Zone Operating Company to promote the region as an attractive duty free shopping region for tourists, but this attempt failed because of the strong opposition raised from the shop owners operating down town. After 1995 the Zone started to attract investors from especially textile firms due to the natural and geographical advantages of the city combined with the logistics and cost benefits provided. By the year 2005, 18 textile firms were set up and employment had raised up to 3800, but the increasing input costs combined with stable foreign exchange and intensifying Chinese competition in this sector led some firms to cancel their textile licences and the yacht building sector started taking the place of textile to become the leading industry of the Zone.

## Yacht Building Sector at Antalya Free Trade Zone

Yacht building is a high value adding industry both for its investors and for the region and the country. Turkey has been achieving an improved position in the international yacht building industry during last 10 years, especially in the Marmara Region (117 companies in Tuzla-Kocaeli-Bursa-Çanakkale), in the Aegean Region (157 companies in İzmir-Bodrum-Marmaris), in the Mediterranean Region (69 companies in Mersin-Antalya) and in the Black Sea Region (36 companies in Bartın-Samsun-Trabzon) (www.yatef.org.tr/haber.htm, 2008). Although Marmara is still the leading region with respect to shipbuilding capacity, Antalya yacht building industry started to attract increased attention during the last four years. Out of 260 yacht building firms in Turkey, 64 are in Antalya, 47 of which are licenced in the FTZ. The Zone has the advantage of being situated close to Antalya Harbour and to the town center. Since the year 2000, 147 yachts sized between 12 to 40 meters were built in the Zone, making a total sales of over 80 million US dollars. The yacht building sector is occupying a total land of 150.000 square meters and when all the licenced firms become fully active, a total of 50-60 yachts sized between 12 to 40 meters can be manufactured every year and the total employment can increase to 3.800.

In the year 2005 the total number of licenced firms in the region was 24 and this number increased to 47 in three years. Out of these 47, 33 are licenced in production, 7 in yatching supplies, 1 in yatching decoration, 3 in purchasing-selling, 1 in yacht supplies production, 1 in yacht repair and maintenance and 1 in slip area operation (Antalya Free Zone Directorate, 2008). Figure 1 illustrates the growth in the cumulative number of yacht building and related firms and the absolute and cumulative number of yachts produced in the region.

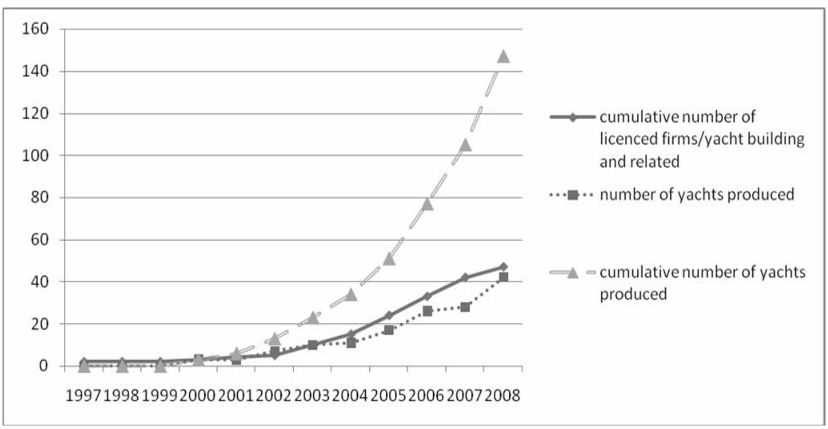



**Figure 1.** Development of the number of firms and yachts produced

## Evolution of the Sector

The first yacht building and related industries licences were submitted in 1997 to two firms and by the end of the year 2008 the total number of licences had risen to 47. The evolution of the sector during this 10 year period will be analysed in two phases as the founding and development years.

### *Founding years: 1997-2004*

During these foundation years 15 yacht building and related firms were licenced to operate in the Zone, but only 11 of these started operation as of end of 2004. The sampling of the present study comprised four of the most important firms of this period. Each manager/founder interviewed gave a subjective narration of the foundation years. The authors combined and cross-checked the stories to obtain a meaningful whole.

The first yacht building company came to the Zone in 1999, as an attractive alternative to Tuzla, İstanbul region which had become very chaotic and crowded with the growing business of shipbuilding in the area. Previously two other firms had got licences but had not started operation yet. The owner founder had 15 years experience in composite yacht building in Tuzla and was looking for a better location for his shipyard. The convenient location of Antalya FTZ combined with the low cost land, the unused machine park buildings (hangars) in the Zone and the convenient climate of Antalya for composite production were the major incentives for the first comers. The first company played an important role in the growth of the sector. The qualified workforce brought by this company comprised the core of the skilled manpower very much needed for high quality yacht building. The later coming companies took advantage of the qualified workforce by hiring people from the earlier companies. And also the social network of the earlier companies played an important role in attracting investors to the region. Among the four firms that were interviewed from the foundation years, only two had invested in the Zone by strategic choice. The other two founded their shipyards out of neccessity, to be able to finish their composite yachts contracted to some earlier firms, which could not meet contract or schedule specifications. The ease of initial investment in the Zone during those years, due to the opportunity of renting large pieces of land suitable for building shipyards, and availability of big machine park buildings left unused from the earliest years of the Zone, the advantageous location of the Zone in Antalya as an attractive touristic destination, combined with the entrepreneurial zest of the first investors must have accelerated he process.

But not comparable with the initial ease of investing, the first investors had to fight with a lot of difficulties in starting and running business. The infrastructure and the bureaucratic services of the Zone were not sufficient to accomodate a completely new and different industrial activity in the region. The legislature concerning the export and import transactions concerning firms in the region were very strict and some of them posed serious hurdles for the firms. The first investors had to spend great effort to initiate some changes in the procedures and legislations of the Zone to be able to alleviate the difficulties. This founding phase of the sector in the Zone can be described as an *unintended agglomeration* of yacht building firms. The years from 1997 to 2002 can be named as the *initiation* phase, while 2003-2004 as the *acceleration* phase.

### Development years: 2005-2009

By the year 2005, the Zone had gained a good reputation among yacht builders from Turkey and abroad as a convenient location for composite-wood and steel mega yacht building. The low cost land and building availability after the closing of textile firms in the Zone because of the downturn of the textile sector in Turkey mainly due to the raising competition from China after 2000 provided space for the increasing demand of yacht building sector. The buildings that were not suitable for yacht building were reserved for the yacht supplies and services firms. Meanhile the efforts of the Zone firms to promote the region as a *specialized cluster for high quality composite mega yacht production* attracted further attention all around the world and in four years the number of licenced firms increased to 47 and operating firms to 33. Only two of the managers of the four firms interviewed from this development phase indicated strategic choice as the primary reason for investing in the Zone. One of the other two firms had also founded its shipyard out of neccessity to be able to finish the yacht contracted to another firm in the region. For the other, the social network with the first investor played a role in attracting the founder who mainly started this business as a hobby, which became a diversified unit of his company.

During this period the Directorate of Antalya FTZ showed greater effort to eliminate the legal difficulties and other organizational hurdles facing the sector. Some regulatory changes were attained from the central authorities in 2006 to facilitate the operation of outsourcing and service-maintenance firms and steel yacht production in the region. Moreover in 2007 *specialization of free trade zones* was started by the National Clustering Project of the Foreign Trade Undersecratariat. Mega yacht production was established as the specialization clustering of Antalya FTZ. This project promises to bring the necessary legislative changes to eliminate the still existing bureuacratic hurdles in front of the sector.

When the whole evolution process is evaluated, it is interesting to note that among the eight firm managers interviewed, only four indicated strategic choice as the primary reason for investing in the region. But in all the cases the common feature of the investing founders was that they were all entrepreneurial characters, involved either in yacht production or some other business previously or concurrently. A second feature common to all was that they were all involved with yachting because of a family or individual history for a strong passion or hobby for boating which resulted in a strong interest, experience and culture in yachting. For three firms in the interviewed group the primary reason for investing was an unsettled dispute with a contracted firm or a partner. The common hobby or passion for yachting can be a strong factor which facilitated the formation of social networks among the investors in the region and fostered the transfer of expertise in yacht building firms.

## Evolution of the firm and cluster level resources

Another group of findings drawn from the data collected concerns the evolution of the firm and cluster level strategic resources and capabilities. The evolution was identified for the founding (1997-2004) and development (2005-2009) phases described above. All the hints obtained from the interview transcriptions and the questionnaires were utilized to identify the resource and capability endowments attained and/or utilized at both firm and cluster-level during each period. The results of this analysis are summarized in Table 1. As can be seen the resources and capabilities strenghtened and enriched considerably from 1997 to 2009. Eventually the human capital and the component and architectural knowledge attained resulted in collective competitiveness of the yacht building sector in the Zone.

**Table 1.** Evolution of the Firm and Cluster Level Strategic Resources and Capabilities

| Level | Resource & Capability | Strategic Resource and Capability Lifecycle | |
|---|---|---|---|
| | | **Founding Stage** | **Development Stage** |
| Firm Level | Resource | * Skilled workforce (transferred from Tuzla and exchanged among firms)<br>* Basic composite production technology | * Over 200 patents in supplies production<br>* High technology equipment<br>* Product quality<br>* Quality certificates<br>* Brand name<br>* Organizational culture<br>* Employee training |
| Firm Level | Capability | * Composite yacht production skills<br>* Social capital (social networking within and outside the firms)<br>* Cognition (experience and culture in yachting) | * Technogical skills (process technology)<br>* Supply chain management skills (working with outsourcing firms)<br>* Design skills<br>* Marketing and brand building skills<br>* High quality mega yacht production skills (component knowledge)<br>* New technology development (steel yacht production)<br>* Adaptability to changing conditions |
| Cluster Level | Resource | * Geographical location (natural inheritance)<br>* Low cost land & hangars availability<br>* Suitable climate for composite production<br>* Proper environment provided by the zone | * Specialized suppliers<br>* High reputation as mega yacht building cluster |
| Cluster Level | Capability | * Social capital (networking among firms) | * Human capital<br>* Component knowledge<br>* Architectural knowledge<br>Collective competitiveness |

### Strategic resource positioning of the yacht building cluster

The same set of findings were also used to draw a classification of the strategic resources of the yacht building cluster according to the typology proposed by Wilk (2003). As defined by the theoretical postulates previously explained, a set of systemic strategic resources, shared by all the firms in the cluster and giving an advantage over other clusters can be easily identified. As can be seen in Table 2 two strategic resources in the systemic category that provides the condition to sustain competitive advantage through immobility and inimitability are the natural inheritance (geographic location, suitable climate, touristic attraction) and industrial localization (advantages of the proper environment of the Zone and the coastal position) of the sector. The other strategic resources in systemic category are the expertise in composite manufacturing technology and the collectively formed human capital of the cluster. These strategic resources were developed and accumulated through the commensal and symbiotic communal adaptations (Hawley, 1950) in the cluster. Consequently, Antalya FTZ has gained the reputation of being the first and only organized region in composite mega yacht manufacturing in Turkey. The valuable and rare human capital in composite production technology has the potential to provide sustainable competitiveness to the cluster because of the unique knowledge base attained through path dependent co-specialization. Two separate firms seem to have gained singular strategic resource through family-owned business and unique market positioning. Also a group of firms was identified to possess constrained strategic resource which creates value only with common usage of certain resources.

**Table 2.** Strategic Resources and Capabilities of the Yacht Building Cluster in Antalya FTZ

| Strategic Resources | Category | Conditions that sustain competitive advantage |
|---|---|---|
| **Natural Inheritance**<br>-Tourist attractiveness of Antalya<br>-Proper climate for composite production | Systemic | Immobility, inimitability |
| **Industrial Localization**<br>-The comparative advantage of Antalya FTZ with its proper regional structure<br>-The localization of Antalya FTZ next to the coast | Systemic | Immobility, inimitability |
| -Expertise in use of composite manufacturing technology | Systemic | Path dependence, architectural knowledge, information asymmetry, non codification of the kowledge, co-specialization<br>= imperfect imitability, imperfect mobility |
| -Collectively formed human capital by the individual firms in the cluster | Systemic | Path dependence, co-specialization, investments in training<br>= imperfect imitability, imperfect mobility |
| -Participation in the history of the cluster<br>-Social ties within subgroup of the firms | Constrained | Path dependence, co-specialization<br>= imperfect imitability, imperfect mobility |
| -Family-owned enterprise | Singular | Path dependence<br>= imperfect imitability |
| -Unique market positioning | Singular | Imperfect imitability |

Figure 2 illustrates the strategic resource positions in the cluster in reference to the proposed classification above. In this figure, Firm 3 and Firm 6 possess singular resources and they differentiate competitively from the rest of the cluster. The strategic resource of Firm 3 is its unique market positioning and of Firm 6 it is the family-owned enterprise. Firm 1, Firm 2 and Firm 5 possess constrained resources that differentiate them from the cluster as a whole. Firms 4, 7, 8 do not possess any singular or constrained resource and have access only to systemic resources. Their competitive performance is supported by the systemic resources and the interaction of the competitive capabilities of all the firms in the cluster. Thus they benefit from collective competitiveness. The only way these firms can differentiate themselves from the other firms and obtain sustainable competitive advantage in the cluster is to use this synergy to create a new resource called "brand positioning".

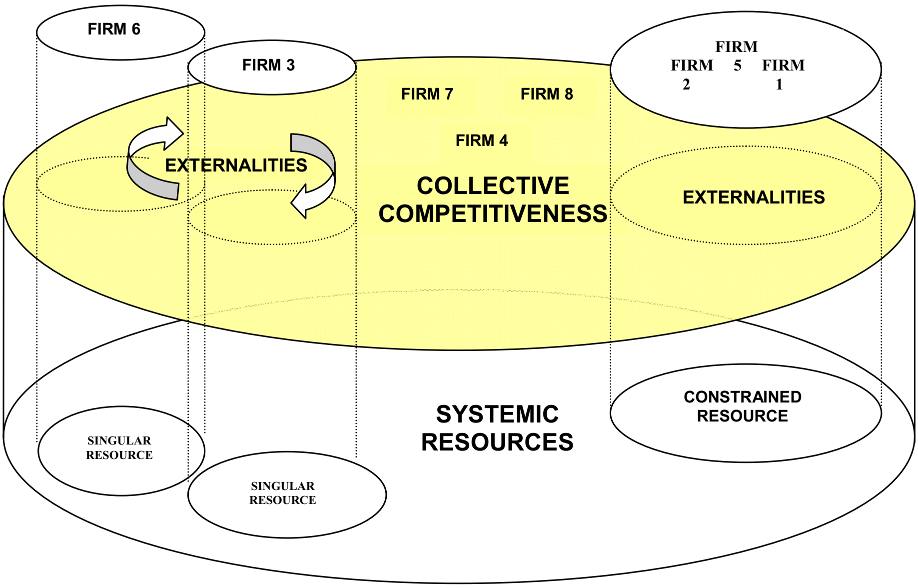



**Figure 2.** Strategic Resource Positions of the Yacht Building Cluster in Antalya FTZ (adapted from Wilk, 2003).

## Strategic resource positioning of the firms in the yacht building cluster

The findings obtained through the questionnaires were used to identify the strategic resource positioning clusters of the firms interviewed. Analysis was carried on the answers to the eleven questions about the sufficiency of a list of strategic resources and capabilities owned at firm-level. This was a subjective evaluation of the firm managers interviewed. The questions in this part of the questionnaire were prepeared according to the strategic resource and capability classifications of Grant (1991) and Helfat and Peteraf (2003). The scores of the 11 variables were factored in two dimensions named as resources and capabilities. The regression coefficients obtained by factor analysis were used in multidimensional scaling analysis to obtain the configuration of the resource and capability positions of the firms as seen in Figure 3.

The figure denotes that besides two outlier firms (Firm 3 and 6) one quite weak in capabilities and the other very powerful in resources but moderate in capabilities, 6 firms interviewed grouped in two resource positioning clusters. Firms in Cluster 1 are quite satisfied with their both resources and capabilities, whereas the firms in Cluster 2 are not not satisfied with their resources. The difference between these clusters is mainly due to their differential position with financial resources. The ones in Cluster 1 seem to have resolved the important issue of financing the very expensive process of mega yacht production which takes at least 13-14 months for completion.

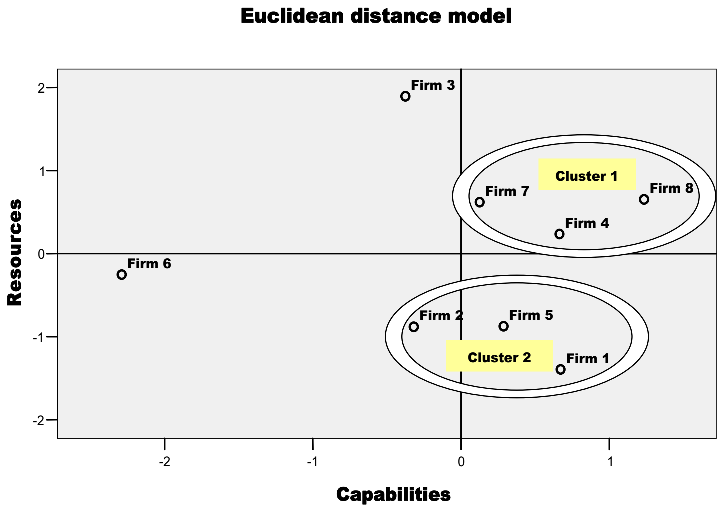



**Figure 3.** Strategic Resource Positions of the Firms in the Yacht Building Cluster

# CONCLUSIONS

Conclusions of this study will be expressed at several levels in accordance with the proposal of Cooke et al. (2005) and the Esser et al. (1996) The research question of the study was the macro level inquiry of the resource based reasons of the surprisingly rapid growth of the yacht building sector at Antalya FTZ. This question was examined at the firm, zone, cluster and policy level, to come up with multi-level answers. *Macro level conclusion* of the study indicates that the fast development of the yacht building sector at Antalya FTZ can be explained as an emergent collective strategy affected by the interplay of dynamic collective capabilities. The foundation phase of the sector in the Zone can be described as an unintended agglomeration of yacht building firms which developed commensal and symbiotic communal adaptations and dynamic capabilities like social capital, human capital and cognition to end up in collective competitiveness of the sector. This development phase of the sector is marked by high reputation of the sector as the number one composite mega yacht production cluster in Turkey which ranks as the 3rd in the world.

*The micro level conclusions* indicate that firms investing in the region benefit from the immobile and inimitable resource endowments of the region but their own resource stocks are diverse, and they employ social networks within and outside the cluster to improve their own resource bases. Some of them have gone into co-specialization with more powerful companies to develop a constrained resource base. Some tried to make use of singular resources. Whatever their own resource endowments all the firms in the cluster benefit from the collective competitiveness attained. The synergy created by the collective marketing and brand building activities of the individual firms create an opportunity for all firms to differentiate themselves with a new brand positioning.

*The meso level conclusions* comprise the evaluations of the firm managers regarding the institutional environment supporting the cluster. The technology, industry and zone policies as reflected in legislations and procedures regulating the yacht business environment in FTZ’s have the potential to foster or hinder a productive and competitive industrial area. The firm managers interviewed reflected a very critical attitude about the supportiveness of the legislations concerning yacht building in FTZ’s. Especially during the foundation years, the laws and regulations fostered difficult barriers for the yacht building firms. Some of these were modified upon successive pressures from the Zone Administration through collective action of the investing firms. Some of the regulations still forming red tape hurdles for the firms in the region are:

1. According to the Free Trade Zones Law the trade between FTZ's and Turkey, the timber of cherry, pear and juniper trees especially demanded for the inner decoration of boats cannot be exported from Turkey because of the ban put on the export of these timbers. The other yacht producing firms outside FTZ's in Turkey are able to buy and use these timbers while FTZ firms have to import them from abroad. This results in unfair competition for firms in the region.
2. The Regulation for Controlled Chemicals put the entrance to and exit from the FTZ's of all the controlled chemicals under control and brought the requirement of getting a Special Licence issued for the company for exporting and importing certain chemicals and their mixtures. Among these chemicals an important item is acetone, which is a chemical very frequently utilized in yacht production and maintenance. Because of this regulation yacht building sector is having difficulty in renewing their acetone supplies.
3. Some firms in the FTZ have licence for both production and maintenance and there is a great potential for mega yacht repair and production business. During maintenance certain goods like propellers, ovens, TV's, generators etc. which could be reused or traded are taken out of the maintained boats. There is no obstacle for selling these goods to foreign countries, but importing procedures are required to sell them to buyers in Turkey. However, since these goods will be second hand it will be necessary to get a special importing licence from the Foreign Trade Undersecreteriat General Administration of Imports. This special licence is issued only for exceptional cases and it has a very long procedure.
4. Moreover the maintenace services in the region cannot benefit from tax exemptions and the tax advantages provided to the firms in the region have been curbed considerably by the recent modifications in FTZ legislation.

*The meta level conclusions* comprise the qualifications of actors and institutions in regional, national and supranational levels in order to create favourable conditions for the industrial dynamism (Wilk, 2003: 5-6). The regional actors having an important influence on the suppotive environment of the Zone are the Directorates of Zone Administration and the Zone Operating Company ASBAŞ. The Association of Zone Investors has also become an actor in contributing to the collective actions and pressures raised by the yacht building group of the association. The interviewed managers mentioned appreciation of the supportive efforts of the Directorate of Zone Administration to bring about positive legislative changes and infrastructure investments as required for the effective operation of yacht building firms. On the contrary, the Zone Operating Company was critisized seriously for profit seeking motives taking priority over supportive activities.

The overall assessment of the activities of these zone authorities indicates still unresolved important problems in the FZT.

- A high technology slipway for launching yachts is the most important deficit of the Zone infrastructure. This puts limitations on the size of the boats that can be built in the Zone and the firms cannot enjoy the benefits of being located in this competitive region. Boat maintenance which can be a very promising business in the region cannot be realised because of this problem.
- Another infrastructure problem of the region is the lack of a system for disposal of normal and dangerous garbage. The solution developed by ASBAŞ for garbage disposal is currently being used but it is said to be very costly.
- Specialized training programs for raising qualified personnel could not be established by the regional or national authorities. The companies generally train their own personnel on the job but those trained personnel are transferred by other companies for higher salaries. Scarcity of qualified workforce poses an important problem and skilled human capital becomes a cost increasing factor rather than a cost reducing one.
- Linkages and cooperation with universities and research and development institutions could not be fostered to back up innovation and technology development in the region.
- The Zone Administration Company charges very high commisions from the business transactions betwen firms in the cluster. This reduces the advantages of operating in the Zone.

The overall assessment of these conclusions indicate that regional and national level actors could not play an influential role in facilitating the formation of the yacht building cluster in Antalya. The infrastructure problems, legislative difficulties, bureaucratic barriers were not effectively and timely resolved to foster the rapid growth of the sector. Until 2007 formation of a specialized cluster of mega yacht building in this zone was not the intended strategy of central authorities. Therefore the rapid growth process observed was primarily mobilized by the communal interactions among firms which collectively developed dynamic capabilities that resulted in collective competitiveness.

# REFERENCES


Antalya Free Zone Directorate, 2008.

Antalya Free Zone Operator Inc. – ASBAS, 2007.

Amit R. and Schoemaker P. J. H. (1993) Strategic Assets and Organizational Rent, *Strategic Management Journal*, 14(1): 33- 46.

Astley W. G. and Fombrun C. J. (1983), Collective Strategy: Social Ecology of Organizational Environments, *Academy of Management Review,* Vol. 8, No.4, 576-587.

Barney, J. B. (1991) Firm Resources and Sustained Competitive Advantage, *Journal of Management*, Vol. 17, No. 1, 99 -120.

Barney J. B. (1986) Organizational Culture: Can It Be a Source of Sustained Competitive Advantage?, *The Academy of Management Review*, Vol. 11, No. 3, 656-665.

Blau P. (1964) Exchange and Power in Social Life, New York Wiley.

Bresser R. K. (1998) Matching Collective and Competitive Strategies*, Strategic Management Journal*, 9, 375-385.

Coleman J. S. (1990) Foundations of Social Theory, Harvard University Press, London.

Collis D.J. and Montgomery C. A. (1995) Competing on Resources: Strategy in the 1990's, Harvard Business Review, July/August, 119-28.

Cook K. S. (1977) Exchange and Power in Networks or Interorganizational Relations, In J. K. Benson (Ed.), Organizational Analysis: Critique and Innovation, Sage Publications, Beverly Hills, 64-84.

Cooke P., Clifton N. and Oleaga M. (2005) Socil Capital, Firm Embeddednessand Regional Development, *Regional Studies*, 39, 1065-1077.

Crook R. T., Ketchen D. J. JR., Combs J. G. and Todd S. Y. (2008) Strategic Resources and Performance: A Meta-Analysis, *Strategic Management Journal*, 29, 1141-1154.

Dahl M. S and Pedersen C. O. R. (2004) Knowledge Flows through Informal Contacts in Industrial Clusters: Myth or Reality?, *Research Policy*, 33, 1673 -1686.

Dollinger M. J. (1990) The Evolution of Collective Strategies in Fragmented Industries, *Academy of Management*, Vol. 15., No.2 April, 266-285.

Enright M. J. (1995) Organization and Coordination in Geographically Concentrated Industries, in Lamoreaux, N. and Raff, D. (eds), *Coordination and Information: Historical Perspectives on the Organization of Enterprise*, Chicago University Press, Chicago.

Esser K. Et alli (1996) Competitividad Sistémica: nuevo desafio para las empresas y la política, Revista de la Cepal, no. 59.

Felin T. and Foss N. J. (2006) Individuals and Organizations: Thoughts on a Micro-Foundations Project for Strategic Management and Organizational Analysis, SMG working paper, January.

Felin, T., and Hesterly, W.S. (2006) The Knowledge-Based View, Heterogeneity, and New Value Creation: Philosophical Considerations on the Locus of Knowledge, *Academy of Management Review*, 32, 172-202.

Foss, N. J. (1996) Higher-order Industrial Capabilities and Competitive Advantage, Journal of Industry Studies, 3, 1-20.

Foss K. and Foss N. J. (2005) Value and Transaction Costs, *Strategic Management* Journal, 26, 541-553.

Grant R. M. (1991) The Resource –Based Tehory of Competitive Advantage: Implications for Strategy Formulation, *California Management Review*, Spring; 33: 3, 114.

Harrison B. (1994) Lean and Mean, New York.

Hervás-Oliver J. L. and Albors-Garrigós J. (2007) Do Cluster Capabilities Matter? An Empirical Application of the Resource Based View in Clusters, *Entrepreneurship & Regional Development*, 19, 113-136.

Hawley A. (1950) Human Ecology, Ronald Press Company, New York.

Helfat C. E. and Peteraf M. A. (2003) The Dynamic Resource Based View: Capability Lifecycles, *Strategic Management Journal*, 24, 997 -1010.

Lawson, C. (1999) Towards a Competence Theory of the Region, *Cambridge Journal Economics*, 23, 151-166.

Maijoor S. and Witteloostujin A. V. (1996) An Empirical Test of the Resource – Based Theory: Strategic Regulation in the Dutch Audit Industry, *Strategic Management Journal*, Vol. 17, 549-569.

Maskell P. and Malmberg A. (1999) Localised Learning and Industrial Competitiveness, *Cambridge Journal of Economics*, 23, 167-185.

Mintzberg H. and Waters J. (1985) Of Strategies, Deliberate and Emergent, *Strategic Management Journal,*6(3), 257-272.

Oliver J. L. H. and Garrigos J. A (2007) Do Cluster Capabilities Matter? An Empirical Application of the Resource-Based View in Cluster, *Entrepreneurship & Regional Devolopment*, 19, March, 113-136.

Pfeffer J. and Salancik R. (1978), The External Control of Organizations, Harper & Row, New York.

Penrose E.T (1959) The Theory of the Growth of the Firm, New York, Wiley.

Peteraf M. A. (2003) The Cornerstones of Competitive Advantage: A Resource Based View, *Strategic Management Journal*, 14(3): 179-191.

Peteraf M. A (1993) The Cornerstones of Competitive Advantage: A Resource Based View, *Strategic Management Journal*, 14, 179-191.

Porter M.E. (1998) Clusters and the New Economics of Competition, Harvard Business Review, November-December.

Porter M. E. (1990) Competitive Advantage of Nations, New York, The Free Press.

Porter M.E. (1985) Competitive Advantage, New York: Free Press.

Porter M.E. (1980) Competitive Strategy: Techniques for Analyzing Industries and Competitors, New York: Free Press.

Rao H. 2002 Interorganizational ecology, In J. A. C. Baum (Ed.), *The Blackwell Companion to Organizations* (pp. 541–556), Malden, MA: Blackwell.

Singh I. (2001) Natural Resource Based Clusters In the New Economy: Theory and Reality, 4. Annual International Conference of The Competiiveness Institute, October, Arizona.

Tallman S., Jenkins M., Henry N., and Pinch S. (2004) Knowledge, Clusters, and Competitive Advantage, *Academy of Management Review*, Vol. 29, No.2, 258-271.

Teece D. J., Pisano G. and Shuen A. (1997) Dynamic Capabilities and Strategic Management, *Strategic Management Journal*, 18, 509-533.

Wernerfelt B. (1984) A Resource Based View of the Firm, *Strategic Management Journal,* 5,171-180.

Wilk E.O. (2003) Resource Based View, Industrial Clusters and Competitive Capabilities: A Case Study in South Brazilian Wineries, Agribusiness Research Centre (CEPAN), March.

Wilk E. O and Fensterseifer J. E. (2003) Use of Resource-Based View İn Industrial Cluster Strategic Analysis*, International Journal of Operations & Production Management*, Vol. 23, 995-1009

www.ant-free-zone.org.tr

www.asbas.com.tr

www.yatef.org.tr/haber.htm

www.dtm.gov.tr

# THE IMPACT OF CULTURAL VALUES ON MARKETING OF CHINESE NATIONAL PARKS: AN EXPLORATORY RESEARCH FOR COMMUNICATION STRATEGY

**Baifang Cheng, Catherine Sarlandie de La Robertie**
**University Rennes 1, France**

## ABSTRACT

*The aim of this study is to draw out the principle values of Chinese tourists to national parks in China so as to improve the parks communication strategy to consumers. The literature clearly provides support and empirical evidence linking both culture and consumption. Cultural values have been shown to be efficient, measurable sets of variable that are fewer, more centrally held and more closely relating to consumer behaviour than demographic and psychographic measures.*

*The data were obtained from a questionnaire on Chinese cultural values, which was distributed to a sample of 133 visitors to national park Potatso. After a descriptive analysis and a factor analysis, we propose some values that can be used in communication strategy to increase the number of visits to Chinese national parks.*

## INTRODUCTION

Ever since the opening of China, the growth of annual economy is always higher than 8%. The quality of life is increasing, more and more Chinese people are leaving for vacation. Tourism is seen as an agent of change from economic, cultural, environmental and social perspectives, and so is utilized in general as an economic engine, boosting the living standards of destination. Confronting with crisis, this industry is set to become more important. China has done many efforts to stimulate consumption - since March 2009, much of Chinese provinces launched their new tourist policy for drawing national tourists to visit their place. 2009 has been named as 'ecotourism year'.

For long time, work is a major part of daily routine but in a modern society, leisure becomes to supplant work as a significant part of an individual's life. In 2008, the domestic travelling population reached 1.6 billion and the domestic travelling income amounted to 777.1billion Yuan (97.1 billion US dollars). More and more tourists are apt to look for authentic, distinctive themes supplemented by a high quality of service along with socially-responsible practice. The experienced traveller indeed epitomizes a special niche sector setting new product trends and encouraging business to design a series of commodities that could prospectively enrich tourist experience. Unlike common offerings prevalent to the mass tourism market, unique leisure initiatives tied to cultural, ecological themes have gradually gained in popularity for those individuals longing for the enrichment of quality of life. These experienced consumers seek educational, psychological and spiritual benefits while travelling.

A national park is firstly a great space associating vocation with protection. Starting from the North-American, the national parks multiplied in the world, the policies of protection and conservation of the landscapes, flora, fauna and water levels, were therefore made compatible with tourism strategies. The concept of national park does exist in different large countries: Canada, Australia, and in Europe too. The same applies to Africa, mainly by the wish of protecting the large fauna which is there considered as exceptional. There are over 9,800 existing national parks worldwide with the Yellowstone National Park in the US being the first one to be established in 1872.

In China, there are 187 "picturesque and famous national sites" managed by the ministry for construction. There is no legal definition of national park in China but some provinces try to introduce the American national park system. The first "picturesque and famous national site" was created in 1982 and the first national park, Potatso, was created in 2006 in Shangri-La, located in the southwest of Yunnan province. "By establishing the Potatso national park, China has taken the first step towards blending tourism development with natural protection," said Song Yinxiu, head of the park's administrative bureau. Before the creation of this first national park, these "picturesque and famous national sites" were generally considered as Chinese national parks. In most cases State Department and local government are sharing the park management. In majority of the Chinese national parks, the priority is given to productivity, which results in the qualitative degradation of sites. Mass tourism increasingly carries negative influences. A new national park system will be a good solution because it tied leisure with cultural, ecological themes. How to balance this relation between supply and of national park in China? Which are anticipations of the Chinese tourist with respect to the national park? What suitable communication strategy can we propose to national park?

The aim of this study is to find out Chinese visitors' of national parks basic values. The literature clearly provides support and empirical evidence linking culture and consumption. Cultural values have been shown to be efficient, measurable sets of variables that are less numerous, more centrally held and more closely related to consumer behaviour than demographic and psychographic measures. Our data were firstly obtained from 9 interviews of visitors of national parks in China and 30 pre-questionnaires. After combining the values obtained in our past research (Sarlandie de La Robertie & Cheng 2007), with the cultural values founded in the questionnaire, a quantitative research of 200 questionnaires is based on the outputs of this preliminary qualitative research and the reviews of related literature. Finally, we propose values that can be used by parks managers (in China or outward China) who want to improve their communication strategy toward Chinese tourists.

# LITERATURE REVIEW

Chinese consumption is varied because the consumers are now confronted with the products of the whole world. Moreover, the fast growth generates a social stratification and a dynamic mobilization in China (Walder, 1989; Bian, 2002). There are no official social classes, but much of Chinese researchers define the consumers by income, profession and other diverse criteria. In spite of stratification, there is not yet in China a middle class like in the industrialized countries'. The Chinese middle class has not a stable income, neither a clear identity nor a distinct system of values. People who are in this class miss also any political motivations which ensure the development of a civil society. In other words, to better know the Chinese consumers in such a fast development, it is necessary to find out other stable and radical factors. We cannot use only traditional factors like social-professional or demographic variables. These variables enable us to know which the consumers are but they do not help us to find reasons which make that the Chinese consumers react differently.

The consumer does not react separately, spontaneously. He lives in a social, political and cultural context. The values are the reflection and the expression of the culture. Hofstede (1991) defines the values as factors that form the core of a culture -- its major demonstrations. A value is the tendency to prefer a certain state of the things to another. The values resulting from a culture are stable and durable variables to understand and predict the behaviour of the consumer. The culture and the whole of the process of socialization make it possible to the individual to build reference marks and to structure his values. Thus values and culture are indissociable. The principal interest of studying values lies in their aptitude to relay the impact of the culture on consumption, and more generally on the behavioural dynamics of the individual. So, it is necessary to emphasize subjacent personal values and their bond with expectations of the consumer; in order to adapt the communication.

The term of "culture", even if it is largely used in the literature found in the field of international marketing and consumer behaviour, is generally defined very vaguely (Hofstede, 1984; Jeannet, Hennessey, 1988; Keegan, 1989; McCracken, 1988; Rohnert, 1984). In general, this term refers to one or more of the following elements:

- significances, attitudes, values and beliefs shared by a group of people;
- modes of reaction to the stimuli and other forms of behaviours common to a group of people;
- symbols and rites used to express significances, values divided and which guide the behaviours and the reaction to the stimuli;
- the way in which those mental constructions and those shared behaviours, like the religion, the family, the education acts.

The culture thus represents "a whole of knowledge, beliefs, standards, values, traditions … acquired by the man as a member of such society" (Hofstede, 1980). It is "collective mental programming" which will result in visible demonstrations, in particular by behaviours, habits, and the ritual. The cultural elements are shared by the majority of one society members; they are learned, because these elements are transmitted to the individuals by the means of many institutions (family, school, laws, media...); they are evolutionary, under the pressure of individual innovations and external contributions.

In marketing, the culture is always an environmental factor. The culture is integrated in all the aspects human being: himself and his personality. The links between culture and consumer behaviour are tight, because to consume is a cultural act. In a recent research, Donnel, Michael and Itamar (2000) show that the culture influences the cognitive process of the consumer when it makes his decision. The culture strongly influences the practices of consumption (criteria selection, marks or products bought...). If the culture of an individual is considered, we can partly understand, explain and envisage his behaviours of consumption. However, the impact of the culture on consumption is not direct. Just as it is difficult to establish a bond between personality and behaviours of consumption, the bond between culture and consumption "is meditative". In other words, the culture acts on "intermediate variables" like: the distribution of the roles of consumption within the family, or, the process of evaluation of the products. The consumer goods convey an attachment with cultural values. They are the bridge by which the individual maintains a link with the cultural environment. This acquisition makes it possible to the individual to be socially by expressing the specific cultural impact of which he profited and the values to which he adheres. On the other hand, the culture cannot be separate with the individuals. It is not a system of abstract values which exists independently of the individuals. The culture is a whole of elements complex, implicit or explicit, bound, learned, transmitted and unconscious of which the values form a part. A value is “a durable belief that a specific mode of behaviour or goal of the existence is personally or socially preferable with another mode of behaviour or goal of the existence opposite or convergent” (Rokeach, 1973). Moreover, the values are organized in "system in a continuum of relative importance". A value does not exist on its own, but rather within a hierarchical system of values. In this system, the values are classified according to their strength; there are always some values more important than others. The cultural values reflect the essential characteristics of the culture (Hofstede, 2001) and constitute some of its fundamental part (Ballinger, Hofstede, 1987). The culture has various functions. It exerts a pragmatic function (provides scripts to guide the behaviour), of adaptation to the environment, identity, and synchronization of the behaviours (Usunier, 2000). The values, in particular, structure the beliefs, the attitudes and orientate the mode of individual behaviour, providing them a whole of solutions to the encountered problems (Terpstra, David, 1985; Rice, 1993; Hofstede, 2001). More general than the motivations, the values are more stable and more structuring than attitudes because they are less laid out to evolve. However the values must be distinguished from the sociocultural standards. These last are very prescriptive. They determine a general framework of operation which makes it possible to the individuals to live together within the same society.

The two principal characteristics of the cultural values are their stability in time and their adaptation. Stability in time supposes that the current cultural values of a society are strongly dependent on its traditional values. At the same time, it is rare that a culture is not sustained to any foreign influence and does not adapt it. To understand the current Chinese culture and values, it proves however essential to study the traditional Chinese culture. According to Sarlandie de La Robertie (2006-2), the traditional Chinese culture is still impregnating the current Chinese culture. This cultural system is not only traditional but also contemporary, and is also turned towards the future, because it is the union of the tradition and reality. It will thus influence the future of the Chinese culture. For this reason, we lay the stress in this research on the traditional culture. Another major characteristic of the cultural values is to influence the human behaviours (Tybout, Artz, 1884). The Chinese consumers have cultural characteristics which are very different from those of the Western consumers (Sarlandie de La Robertie, 2004). Five decades ago, Kluckhohn and Strodtbeck (1961) developed their values orientation theory (structure K&S). This structure was subsequently used by Yau (1988, 1994, and 2002) to study Chinese cultural values in the context of marketing. Moreover, Bond and his Hong Kong colleagues have developed a trans-cultural research programme based on Hofstede’s method. In the 80s, Yang (1986) looked further into the profile of Taiwanese values in the context of modernization, and drew up a list of the changes recorded in the value system.

In 1994, Yau (1994) proposed a model of the Chinese consumer’s satisfaction/dissatisfaction, in which values are the important and independent variables which affect expectations relating to the product, satisfaction, and the intention of purchase. It is a typology of 12 values, which are gathered in 5 dimensions: “man and nature”, “introspection”, “relationship”, “time”, and “personal activity”. The “man and nature” dimension includes values relating to the harmony with nature. The Chinese think that the man is a part of nature. Man must neither exceed it, nor control it. Man can only adapt to nature in order to reach a harmonious state. In this dimension, there is also a value which is called *Yuan* (fatality, □), which affirms the relation predestined between the man and the other things. This value generates the fact that people must rely on themselves and cease complaining in difficult circumstances, because all is envisaged. Individual internal dimension includes the values of the humility, in which modesty is essential. It is necessary to avoid saying not to the others and to be flexible because one must act according to the current circumstance. Relational dimension shows the values like the respect of the authority, the dependence, the face and the orientation of the group. Yang (1981) defines the social orientation as "a predisposition towards models of behaviour like social conformity, the use of non offensive strategies, the tender with social waiting, and the value granted to the external opinions, with the aim of achieve one or more goals. These objectives can be obtaining rewards, the maintenance of the harmony, the control of the feelings, the will to save the face, social acceptance. It can be a question of avoiding punishments, the embarrassment, the conflicts, the rejection, the ridiculous one, and reprisals in a social condition. Basically, that represents the tendency of a person to act as agreement with external waiting or the social standards, rather than according to the interior wishes or of the personal integrity, so that it is capable to protect his ` me public' and his social functions, as an integral part of the social network. The “time” dimension shows that the Chinese attach a strong importance to the tradition. They are proud of their long history. Continuity is very important for them. In the ”personal activity” dimension, one seeks a harmony with the others. One avoids the conflict and seeks an external harmony like internal one too. In the field of human relations and especially in the family circle, Chinese people continue to attach importance to the concept of *Zhong-Yong* ("Constant Mean" □□), whose purpose is to maintain balance and harmony, directing the mind to a state of constant equilibrium. Such are dominant values which express cultural bases that we can find in the Chinese society (Sarlandie de La Robertie, 2006-1).

Yau proposed a questionnaire which contains 45 proverbs to describe these five dimensions of the Chinese cultural values. These values are used in our earliest research in order to explain Chinese consumer behaviour because of this culture specificity. We added the harmony (□□□Hexie), which is a central concept in the Chinese culture -- the harmony between man and nature, the social harmony.

Some other Chinese researchers, Zhang (2003, 2005) and Liu (2006) proved the relationship between Chinese consumer values and Chinese traditional culture, too. Liu (2005) combined Yau’s typology of 12 values (organized into five dimensions) and Hofstede’s researches, he provided a typology of 30 values, organized into 7 dimensions.

# METHODOLOGY

Both qualitative and quantitative methods were used in our research to find out Chinese tourists’ cultural values. At the first stage of the research, face-to-face interviews with 9 Chinese visitors (aged from 20 to 57) of national parks were used in order to understand why and how they have chosen their visit at national parks. After combining important expressions of these interviews, the reviews of related literature and our prior research, a small-scale questionnaire survey is carried out with the initial questionnaire, aiming to test whether the questionnaire is suitable for further research. Then data have been collected through a questionnaires survey in the national park Potatso between 21st July and 4th August 2008. The sampling frame consists of randomly selected 200 persons. As a result, the effective sample size of the study is 133. All questionnaires are in Chinese. There are two parts in final questionnaire: the first part proposes 85 items about Chinese traditional culture. Likert’s five-point scale is used in the first part. The second part is about the tourist behaviour in national parks. Another 9 questions about demographic characteristics of respondents are added.

The 9 interviews were volunteers and agreed to spend 45 minutes or one hour being interviewed individually. The interviews were conducted in Chinese, their mother tongue. There were two parts in the interview schedule. First part tried to understand why he/she visited a national park. In the second part, they discussed how Chinese traditional values influence them. To conclude, a third part was set apart for answers to the two principal questions: 1) what do you think about a national park? 2) What do you expect from a national park? Everyone wants to have a rupture from daily routine. They agreed that the traditional values play an important part in their life. They can feel the harmony between human and nature in national parks and famous landscapes.

The resultant data derived from the qualitative work enabled the study to set up a scale of traditional values into the survey questionnaire. We selected 80 daily expressions; a lot of expressions were proved by scholars Yau, Zhang and Liu in their researches, and we added some terms about tourist activities. A five-point Likert-type scale, with 1 referring to “complete agreement”, and 5 to “complete disagreement”, was used for measurement.

To strengthen the content validity, tourism professors, tour operators were asked to review the questionnaire to see if there was any ambiguity and mistake shown in draft questionnaire. After the content validity was secured, a pilot test of 30 subjects was conducted to ensure the clarity of wording again and to statistically test reliability of measurement using a Cronbach alpha test (=0.824). The study found that the initiate scale had an acceptable reliability score.

The questionnaire for the survey was written in Chinese. It was translated into English for the data analysis and interpretation. The national park Potatso agreed to join the study. In this regard, the study population was individual tourists. A series of on-site surveys was conducted by 15 students from the faculty of ecotourism, Southwest Forestry University. The participants were selected when they were waiting tourist coach or taking a rest. It should be underlined that visitors have little time for rest, 67 questionnaires were not able to complete in time. In total, the sample of 133 visitors was deemed as useful and further analyzed. As for the data analyses, after descriptive analyses, we used factor analysis to reduce attributes to fewer dimensions. The descriptive analyses aimed to address the first research objective proposed by the study. The factor analysis was used to find key traditional values.

# FINDINGS AND DISCUSSION

## Experimentation and findings

The descriptive statistics of the respondents were conducted using the frequency tests and the demographics were illustrated (table 1). These visitors travel at least once a year, and more than 17% take a trip more than three times a year. Moreover, 30% travellers have visited outside China.

**TABLE 1: DEMOGRAPHICS OF THE SAMPLE (N = 133)**

| | Descriptive | Frequency | Percentage |
|---|---|---|---|
| **Gender** | Male | 66 | 49.6% |
| | Female | 67 | 50.4% |
| Age | 16-24 | 51 | 38.3% |
| | 25-34 | 41 | 30.8% |
| | 35-44 | 29 | 21.8% |
| | 45-54 | 9 | 6.8% |
| | 55 or above | 3 | 2.3% |
| **Education** | Primary or below | 0 | 0% |
| | Secondary | 36 | 27.%1 |
| | Graduate | 79 | 59.4% |
| | Post-graduated or above | 18 | 13.5% |
| **Occupation** | Student | 44 | 33.1% |
| | Retirement | 2 | 1.5% |
| | Professionals | 10 | 7.5% |
| | Professor, researcher | 34 | 25.6% |
| | Senior management | 10 | 7.5% |
| | Middle management | 8 | 6.0% |
| | Public service | 5 | 3.8% |
| | SME Manager | 1 | 0.8% |
| | Works | 7 | 5.3% |
| | Others | 12 | 9.0% |
| **Income** | 1000 Yuan or below | 10 | 7.5% |
| | 1001-1500 Yuan | 14 | 10.5% |
| | 1501-2000 Yuan | 16 | 12.0% |
| | 2001-3000 Yuan | 15 | 11.3% |
| | 3001-4000 Yuan | 16 | 12.0% |
| | 4001-5000 Yuan | 17 | 12.8% |
| | 5001 Yuan or above | 45 | 33.8% |

The test of Cronbach's Alpha on the values scale is conducted and finds an acceptable (=0.918) score. The finding outlines a reliable scale of measurement in regard to traditional values. Its internal validity, tested by Pearson's correlation, shows no item above the 0.01 level. The ρ of Jöreskog is over 0.75. Likewise, T-test for all items shows no item above 5, which means an alpha level of 0.01. Our scale of Chinese traditional values is thus both reliable and valid. We did an exploratory factor analysis and we got the KMO of 0.805. The result of Bartlett test of sphericity is in table 1.

**TABLE 1: INDICE KMO AND BARTLETT TEST**

| | | |
|---|---|---|
| Kaiser-Meyer-Olkin. | | ,805 |
| Bartlett test of sphericity | Chi-square test | 2403,124 |
| | ddl | 946 |
| | Significance of Bartlett | ,000 |

These two indices showed our data can be used a factor analysis.
Finally the principal component analysis (with the rotation method Varimax) produced 12 factors, accounting for 76% of the variances. The first 6 factors are presented in table 3.

## TABLE 3: FACTOR ANALYSIS OF CHINESE CULTURE VALUES

| N° | Factors |
|---|---|
| | **Factor 1: Harmony with people and importance of the family. (Variance % = 11.14%)** |
| 34 | We should keep harmonious with others. |
| 35 | A man depends on his friends when he is not at home. |
| 65 | A family will be prosperous if it is in harmony. |
| 6 | It is my parents' guide that leads me to a right career choice of my life. |
| 75 | I am used to listen to my parents' instruction. |
| 3 | Words of my parents are important to me. |
| 4 | I respect my teachers just as I respect my parents. |
| 49 | I always pay attention to my teachers' edification. |
| 73 | When I make an important decision, what I consider first is my family's interest. |
| | **Factor 2: Situational dependences. (Variance % = 7.73%)** |
| 78 | The consuming behaviour should match with the consumer's social identity. |
| 37 | One's apparel should match his/her identity. |
| 30 | One's behaviour should match his/her social status. |
| 25 | Whether to express one's opinion should depend on the situation. |
| | **Factor 3: Group orientation. (Variance % = 5.88%)** |
| 39 | The ability to cooperate with others is more important than the individual ability. |
| 76 | The feeling of involving in some organization is very important for me. |
| 29 | Sometimes we have to sacrifice our individual interest for human beings' interest. |
| | **Factor 4: Harmonious life with nature. (Variance % = 5.72%)** |
| 1 | For humanity's happiness, the humanity should obey the nature. |
| 17 | National park and scenery scenic spot area can let me feel the harmony between human and nature. |
| 11 | I love the nature. |
| 68 | For avoiding natural calamity, human must conquer the nature. |
| 83 | I do not like environmental protection because it causes inconvenience to me. |
| 33 | I hope that I can live in a beautiful place. |
| | **Factor 5: Universal harmony (Variance % = 4.80%)** |
| 21 | I like the tranquil life. |
| 26 | I prefer a simple life to a material well-being life. |
| 24 | I do not like complicated things. |
| 79 | Let nature take its course |
| | **Factor 6: Yuan (fatality). (Variance % = 4.51%)** |
| 19 | I am the only one who can be responsible for my behaviour. |
| 18 | Life is fated. |
| 64 | Do good work for people and animal, you will have a good retribution. |
| 41 | I believe that the spirit is immortal. |
| 63 | I hope I can realize a better life in the world to come. |

There other factors were: group orientation, self-control, independence and autonomy, respect for experience, and health. We found three factors which tied with 'harmony'. The Chinese value "harmony", can be internal (a mix of physical health and psychological balance) as well as external (relations with others, with objects and nature). 82% of visitors thought human must respect the nature. More than 90% visitors will take part in environmental protection despite it causes sometimes inconvenience to them. 91% visitors found the harmony between human and the nature in national park where they enjoyed a physical and spiral experience. There is a very strong 'man-nature' orientation as well as a positive attitude towards ecology. There are also 91% visitors dreamed a simple life.

The Chinese seek independence and autonomy within the bounds of their in-group's orientations. The family is always at the centre of Chinese society. A good relationship is emphasized mainly as a source of potential support and help. Families and friends often decide what is to be done and are regarded as essential resources to succeed in life. The visitors aged upon 35 prefer travelling with family and the visitors aged from 16 to 34 like a travel with their friends. On the other hand, the importance the Chinese attach to self-control increases correspondingly. In short, the Chinese visitors needs a national park to fully relax, enjoy good moments with family and friends, find harmony with nature, and gain specific knowledge about it.

## Discussion

There is not yet any research which uses the Chinese traditional values in order to figure out tourists' behaviour. Our scale is reliable and valid in this research. But some items were not significant (for example item13 and item 15). We must pay attention for those items in our future study because we have another group of data – 454 questionnaires realized outside the national park.

The on-site survey in this study was done in the national park Potatso, where the ticket price is 260 Yuan (33 US dollars). Few famous sites keep so expensive ticket. Maybe it is the reason why we found that the visitors' average income is quite high: 67.6% of them have more than 2000 Yuan (313 US dollars) a month while the average income of Chinese is only 1500 Yuan a month. Moreover, 73% visitors held a university degree. We need a larger sample for testing our questionnaire. In our survey, few aged people were concerned, however more and more aged people travelling nowadays.

Like any method, the factor analysis is not free from inherent limits. Its implementation suffers in particular from the ponderous and sometimes artificial character. It is necessary to deal with a significant number of subjects for the factors derived from analysis with more objective socio-demographic criteria. With other 454 questionnaires, a regression analysis will be done in our future study.

# CONCLUSION

The Chinese government defines a national picturesque site as a space to be admired by the people for its natural, cultural and scientific assets. On such a site, landscape, fauna, florae blend harmoniously with culture. All natural resources on it are strictly protected by the state. In their communication strategy, the national parks can firstly underline 'a place for harmony, natural and social', because in Chinese culture man is part of nature. Human activities thus enjoy pride of place in Chinese national parks – a major difference from other countries. In addition, park management can emphasize this or that value according to its principal feature. For instance, Park Potatso management can highlight a pure natural landscape where the fauna and florae are scare and where ethnic minorities such as the Tibetans are still living from generation to generation. The beauty of nature and the specific culture of one ethnic group will enrich the visitor's knowledge, which is so acquired by the high-educated and experienced national park tourist. A national park is also used to show an ecological harmony. For a national park known by mountain sites, achievement, wisdom, friendship and positive feelings all figure prominently among the values referred to. For the historic sites, deferential regard for experience, reflectiveness and intelligence are of primary importance. Furthermore, increasingly environment-conscious tourists do not only seek a break with everyday life. They expect the national park they visiting to minimize degradation of natural resources, as well as to maximize services based on their values. Combining environmental concerns, heritage conservation, scientific and tourist development, park activity becomes multipurpose, hence complex, and creates a requirement for professionalized personnel. In marketing strategies, plural values must now be factored in: nature and health, harmony, thirst for new experience and knowledge.

From the values highlighted in this research, it is so possible to derive conclusions that are policy-relevant for managers anxious to improve the attractiveness of national parks and communication with their visitors and in brief, to refashion the public image of Chinese national parks and change the terms of 'dialogue' with the tourists. Also, we can observe that these conclusions apply too to the communication strategy that "foreign" national parks – *i.e.* outside China – would need to set up in order to attract tourists from China.

# REFERENCES


Ballinger, D. and Hofstede, G. (1987), Les Différences Culturelles dans le Management, Les Editions d'Organisation, Paris.

Bian, Y. (2002), Chinese social stratification and social mobility, *Annual Reviews Social*, 28, pp91-116.

Chieh-Lu, L., and Poh C.L., Garry E.C., Harry C.Z. and Alan R.G.(2007), Cross-cultural Models of Customer Service : A Case of Country Park Recreation in Hong Kong, *Journal of Park and Recreation Administration*, 25(3), pp 41-66.

Dong, J.S. and Chen T.(2006), 基于文化价值观的消费者行为研究, *Jourrnal of Liaoning Institute of Technology*, 8(5), pp18-21.

Donnel, A.B., Michael, W.M. and Itamar, S. (2000), Reasons as carries of culture: Dynamic versus dispositional models of cultural influence on decision making, *Journal of Consumer Research*, 27, pp157-178.

Hofstede, G. (1980), Culture's Consequences: International Differences in Work-Related Values, Sage Publications, Thousand Oaks, CA.

Hofstede, G. (1984), The Cultural Relativity of the Quality of Life Concept, Academy of Management, *the Academy of Management Review*, Jul, p.389-398.

Hofstede, G. (1991), Cultures and Organizations: Software of the Mind, McGraw-Hill International, London.

Hofstede, G. (2001), Culture's Consequences: Comparing Values, Behaviors, Institutions Across Nations, Sage Publications, Thousand Oaks, CA.

Jeannet, J.P., and Hennessey H.D. (1988), International marketing management, MA: Houghton Mifflin, Boston.

Keegan, W.J. (1989), Global marketing management, Prentice Hall, Englewood Cliffs, NJ.

Kluckhohn, F.R. and Strodtbeck F.L. (1961), Variations in Value Orientation, Evanston, IL: Row, Peterson & Co.

Liu, S.X. (2005), 中国消费区域差异特征分析，Sanlian Publications, Shanghai, China.

Liu, S.X.(2006), 从文化价值的角度看消费形态, *Economic Management*, 7, pp49-52.

McCracken, G. (1988), Culture and Consumption, Indiana University Press, Bloomington.

Oliver, R. L., Rust R. T., Varki S. (1997) Customer Delight: Foundations, findings, and managerial insight, *Journal of Retailing*, 73(3), pp311-336.

Rice, C. (1993), Consumer Behavior: Behavioral Aspects of Marketing, Butterworth Heinemann, Oxford;

Rohnert, P.R. (1984), Toward a Conception of Culture in Cross-Cultural Psychology, *Journal of Cross-Cultural Psychology*, 15, pp.111-138.

Rokeach, M.J. (1973), The Nature of Human Values, Free Press, New York.

Sarlandie de La Robertie, C. (2004), Intercultural Aspects: Chinese Consumer Behavior (in Russian). *Politics and Business in the Changing World*, Fourth International Conference Proceedings. Obninsk, Russia, pp. 63–68.

Sarlandie de La Robertie, C. (2006-1), Gestão nos países sob influência de Confucio : Implicações culturais, *Global Economics and Management Review*, Lisboa, vol.11, N°3, pp.51-69.

Sarlandie de La Robertie, C. (2006-2), China: About the Bond Between Management and Cultural Patterns – System of Values' Influence on Managerial Practice (in Russian). *Politics and Business in the Changing World*, Fifth International Conference Proceedings, Obninsk, Russia, pp. 231–239.

Sarlandie de La Robertie, C. and Cheng, B.F. (2007), Values in the Marketing of National Parks in China : an Exploratory Application of Means-End Chain Theory, *Euro Asia Journal of Management*, 17(1), pp79-102.

Terpstra, V., and David, K. (1985), The Cultural Environment of International Business, South-Western, Cincinnati.

Tybout, A.M., and Artz, N. (1994), Consumer Psychology, *Annual Review of Psychology*, 3, pp.131-169.

Usunier, J.C. (2000), Marketing Across Culture, 3rd edition, Financial Times/prentice Hall, London.

Walder, A.G.(1989), China Social Change in Post-revolution China, *Annual Review of Sociology*, 15, pp405-424.

Yang, K.S. (1986), Chinese Personality and its Change. In Bond, M.H. (ed.) The Psychology of the Chinese People, Oxford University Press, New York.

Yau, O H.M. (1988), Chinese Cultural Values: Their dimensions and marketing implications, *European Journal of Marketing*, 22, pp44-57.

Yau, O.H.M. (1994), Consumer Behavior in China: Customer Satisfaction and Cultural Values, Routledge, London.

Yau, O.H.M. and Kwong, K.K. (2002), The Conceptualization of Customer Delight: A Research Framework, *Asia Pacific Management Review*, 7(2), pp255-266.

Zhang, M.X. (2003), 绿色购买行为的道家价值观因素分析, *Economic Management*, 2(4), pp34-41.

Zhang, M.X. (2005), 女性价值观与购买行为, Jingjiguanli Publication, Beijing.

# THE IMPORTANCE OF CONSTRUCTING EFFECTIVE CORPORATE CULTURE FOR GLOBAL WORKFORCE: A NATIONAL AND ORGANIZATIONAL CULTURE PERSPECTIVE

**Tijen ERSOY HARCAR**
**Izmir University of Economics**

## ABSTRACT

*This paper addresses the importance of constructing an effective corporate culture across nations in organizations that could be used as global competitive advantage for the companies, which have to deal with a diverse and mobile global workforce. On the other hand, while constructing this corporate culture for such a diverse and mobile workforce, there is a complex interaction between societal, organizational and individual culture levels in corporations that needs to be taken into consideration. These three levels interact constantly with each other under the effect of both individual's nationality and home/host country's national-organizational cultures in the process of constructing an effective corporate culture. Trompenaars' organizational culture categorization and Hofstede's two national culture level dimensions are used to create a strong, global worker oriented organizational culture. Paper introduces a conceptual framework and suggests that once such a corporate culture is constructed effectively, it will create a well-functioning organization for its diverse workforce, which will enable the organizations compete globally while keeping the high skilled employees in this fast paced business environment.*

## INTRODUCTION

The economic and the managerial literatures have long described the phenomenon of increased global business competition occuring around the world (Adler, 2002; Griffin, 1999). This phenomenon of globalization has created a need for competition on a global scale, which also brought the mobility of workforce, both managing/working with local people in a local workplace or working for a multinational company full of diverse people in different host countries. There are different theories and ideas regarding globalization to include the modernization perspective, dependency theory, theories of imperialism, hegemony theory, world-system-theory, and globalization research (Clifford, 2007). There are different key features that can be associated with the term globalization and is found throughout the literature. Maguire (1999) states however, "is repeatedly made to the idea that globalization involves some form of greater interdependence between local and the global...it is clear that every aspect of social reality, our activities, conditions of living, belief systems, knowledge base and responses, is affected by interconnections with other groups, both near and far away" and Giddens (1990) suggests that as these interconnections intensify and increase, the world becomes compressed (Clifford, 2007).

In this paper, there are two facets of the globalization of organizations; first is the individual level from the global manager's point of view, who tries to adjust both a host country's national culture and organizational culture at the same time. The second is the organizational level from the corporate point of view, which tries to ensure to have such an organizational culture that will create an effective workplace for its global workforce.

Literature has indicated that often home country management practices do not transfer well to foreign locations. Not only the management practices, but there is also the issue of adjusting and adapting to the foreign national and organizational culture of a host country as a global manager, specifically from the local national culture perspective and specific work values typical to it. From the corporate perspective, the organizational effectiveness strategy designed to minimize the complexity of intercultural management and also is consistent with the ideology of Jack Welch's "boundaryless organizations" (Dulnik, 2004). Ralston, et.al. (2008) argued that for most multinational corporations (MNCs), being global implies having a universal corporate culture, which leads to reinforcing in the country of operation the same practices as in their country of origin. Schwandt and Marquardt (2000) emphasized that "global organizations are companies that operate as if the entire world a single entity". However, over the years, an increasing number of scholars have begun to argue that the transferability of management theory and resulting managerial practice may not be as easily achieved as previously thought or may not lead to the organizational outcomes desired by those multinational corporations in their respective host countries. Similarly, for the global worker from a different background, the company cannot manage its workforce only through its local management practices either. Therefore, it is clear that there is a need for a common understanding of work values, which might lead universal work values in the future, both from the global manager's and the corporation's point of view that will create an effective organizational work environment. As Robbins (1996) argued that national differences and the national cultures must be taken into account if managerial practices of MNCs are to become successfully implemented and have a successful outcome outside of their home country, companies in host countries should also create such an organizational culture for its global workforce, who would adapt easily and feel comfortable in their work environment (Dulnik, 2004).

Bringing the above points together, the purpose of this paper is to explore the connections between national culture and organizational culture within the context of global workforce in organizations. It also examines the implications of these connections for the conceptualization of such corporate culture in light of national and organizational cultures. Therefore, the paper is structured into three key parts; It starts by presenting the conceptual framework, utilizing literature on national culture, organizational culture and organizational globalization, while looking into the two level culture interaction to construct workplace culture. In the final section, paper introduces some proposals and suggestions in relation to the above objectives, and to previous research. Therefore, in this paper, the organization's responsibility to create such an effective workplace for its diverse workforce will be discussed for better functioning organizations in today's global business world.

## Literature Review and Conceptual Framework

Recent literature on identity in organization studies consistently suggests that it is a multilevel construct (Albert, Ashforth and Dutton, 2000; Brown, 2001) and that it is useful to differentiate between corporate, organizational and individual identities within organizations. While corporate identity is closely linked with discussions of image, and typically focuses on 'how the central idea of a corporation is presented to its various constituents to achieve the corporation's strategic goals' (Gioia, et.al, 2000), there is much less consensus on the definition of organizational identity (Albert, Ashforth and Dutton, 2000; Hatch and Schultz, 2002;1997). This lack of consensus seems to derive in part from divergent responses to the seminal work of Albert and Whetten (1985) who defined organizational identity as organizational members' collective understandings of that which is central, enduring and distinctive about an organization. Critiques of this definition typically address the idea that an organization can have multiple identities and that identity is more in flux and flow than Albert and Whetten's definition suggests (Whetten, 2006). Also connected to the idea of identity as a multilevel construct is a growing interest in understanding the connections and relationships between different forms of identity (Albert, Ashforth and Dutton, 2000; Brickson, 2000, 2005). The typical emphases here are on the relationship between image and identity (Alvesson, 1990; Gioia, et.al, 2000; Hatch and Schultz, 1997) or organizational identity interventions and employee identity (Alvesson and Willmott, 2002; Brickson, 2000) as well as the dynamics of multiple organizational identities and multiple self-identities (Brown, 2006). Of particular relevance to this paper is an emerging line of inquiry (see, for instance, Alvesson and Willmott, 2002; Haslam et al., 2003; Ravasi and Schultz, 2006) that responds to Pratt and Foreman's (2000) challenge to researchers 'to link individual-level dynamics with the broader dynamics facing members in their organizational settings'.

On the other hand, the role of the 'national' or the 'local' in global business and management activities has been the subject of organization studies for decades. Identifying the relationship between national identity and organizational globalization then may be sufficient for the purpose of the paper, so the differences in preferred national organizational forms, managerial values and working practices are being replaced by global corporate cultures and universal organizational identities. According to this view, national identity and organizational identity are increasingly disparate, perhaps even disconnected entities. But the paper suggests a more complex and interconnected picture of the relationship between these two forms of culture and identity. Therefore, linkages between culture and identity affect work values and managerial practices, both of which are important markers of creating a healthy and well-functioning corporate culture. Indeed, social integration is a basic ingredient of any description of a good corporate culture. All people should get the opportunity to realize their full human potential, i.e. to realize their own goals and aspirations while serving the organization they work for. Figure 1 draws a broader perspective of the paper and major determinants behind the theoretical framework.

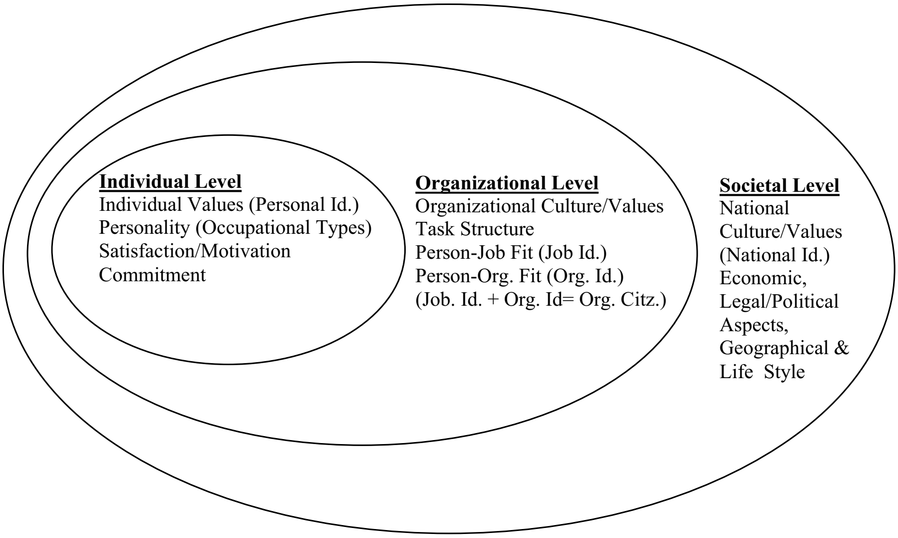



**Figure 1-Broad Perspective of The Study; Tijen Ersoy Harcar, Feb 2009**

As it can be followed in Figure 1, three level interacts to each other, but for the purpose of this paper, only the two levels, which are national and organizational level cultures will be taken into consideration this time. Following this paper, individual level culture interaction will also be included and analyzed as a future project for the completeness of the broader perspective presented above.

The focus of this study is the imbalance between a global manager's (expatriate) societal values and beliefs, which come from his/her own national culture, and the philosophies and traditions of the organization (organizational culture) in which the global manager works. That is, incongruence between expatriates' national cultural values and organizational cultural values is likely to unfavorably impact on expatriates' success along with some important organizational outcome variables, such as expatriate performance, absenteeism and/or withdrawal from the assignment. An imbalance between societal and organizational cultural values may be particularly important for organizations in less developed/developing countries. In a climate of increasing globalization and concomitant increasing competition, there is enormous pressure exerted on such organizations to restructure to enable them to compete successfully in a borderless world. Progressive local firms in less developed /developing countries may, among a repertoire of restructuring strategies, consider changing their organizational culture to mimic the culture of successful organizations from the more industrialized nations. The implementation of an organizational cultural change, without reference to the surrounding societal values, may jeopardize the success of that change. For example, a firm with an organizational culture characterized by a more centralized decision-making structure may, in response to a rapidly changing environment, change to a culture that encourages greater decentralization of decision-making authority and responsibility. While in societies where paternalistic dependent work values prevail, the resultant incongruence between the expatriate's societal values and the changed organization cultural values (emphasis on decentralization) may contribute to untoward outcomes in the workplace. The opposite might occur depending on the host country nation’s cultural values. A number of studies have emerged examining the impact of the fit between managers' societal values and organizational processes and structures on key organizational outcomes (Joiner, 2001). Thus, the aim of this study is to construct an effective corporate culture from the societal/organizational culture perspective for the globally mobile workforce that they can achieve high levels of managerial performance on their assignments.

The key questions of the paper is; What is the relationship between the corporate culture of the organization and national culture and what would be the best match to create an effective corporate culture for expatriates which might vary based on host country’s national culture?

The assumptions of the paper; it is assumed that while there are many influences on an individual's thinking and behavior patterns, culture plays an integral part. Second assumption is that most of the time, national cultural values might reflect an individual's values as well. There are two different opinions on this issue regards to cross-cultural affect on managerial values. Convergence theorists tend to cite the fact that there was considerable similarity in the manager's responses and suggests that a manager is a manager, regardless of a country of origin (Al-Jafary & Hollingsworth, 1983). Divergence theorists, on the other hand, point to the fact that there were some cultural differences identified in the research that led to a grouping of similar vs. dissimilar cultures (England, 1983; Hofstede, 1984). In this paper, divergence theorists' point of view will be taken into consideration.

The limitations of the paper; as it is stated before, this paper does not examine the individual level values this time. Therefore, temporal issues, the sequence of activities in the process of developing work values, and the nature of interactions between individuals are outside of the scope of this paper. The paper carries the intention to provide information and formulate opinions about whether national culture in general makes a difference in organizational values.

## Definition of Key Terms

With the trend of globalization, which the world has experienced since the 1980s, the concepts of culture have consistently gained popularity in the thory and practice of organization and management (Adler & Jelinek, 1986; Mintzberg, 1990). The concepts of culture were so plentiful, difficult, and vague that some have argued that they are impossible to systematically research (Mintzberg, 1990).

According to Hofstede, culture is the collective programming of the mind, which distinguishes the members of one human group from another (Hofstede and Hofstede, 2005; 1985). Figure 2 explains the details of Hofstede's culture definition below.

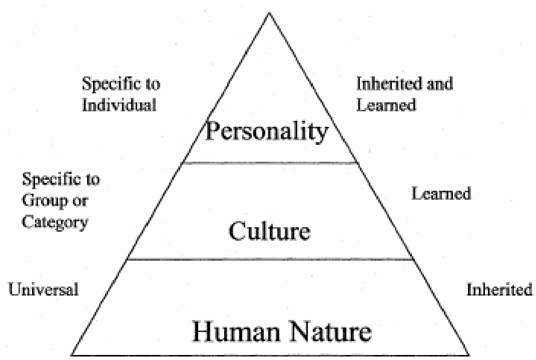



Figure 2: Hofstede & Hofstede's (2005, p. 4) Three levels of Uniqueness Model of Cultural Programming Levels

A cultural belief system develops from shared experiences of members of society. Beliefs are generally expressed as symbolic meanings used to describe, define and relate to the relationship of the group member to society; values are "internalized attitudes about what is right and what is wrong, ethical and unethical, moral and immoral" (Yukl, 1994). Other scholars have emphasized that values are always central to the concept of culture (Rokeach, 1971). Recognizing that values are central to the concept of culture, some scholars have opted to look at the differences in the value systems on the national level as the source of this complexity. Of those scholars who have looked at the nationally driven differences in values systems, most have concerned themselves with the managerial levels of organizations (Ralston et al., 2008; Adler, 2002; Elizur, et.al, 1991).

The national culture construct is based on Hofstede's definiton of national culture as a collective programming of the mind (this definition is in its esence reflective of a definition proposed by UNESCO in 1982), which says that the very definition of national culture is all distinctive, spiritual and material, intellectual and emotional features, which characterize a society or social group. Therefore, for the purpose of this paper, Hofstede's culture and national culture definitions will be taken into consideration.

Weech (1999) proposed that the national culture of a home country directly influences the managerial work and activities for the expatriates in the country in which they are working. The question to ask, therefore, is whether the influence of the foreign managers over the work values of their local corporate culture is so strong that it overpowers the local national culture ones. Or for the expatriate in the host country, it is the opposite question, host country's corporate culture is so strong that it overpowers the expatriate's his/her own national culture values. Values are a central component of culture. Work environment is a special component of the overall corporate value system, which, in turn, is reflective of the national culture.

The basic proposition of this study is that the difficulties faced by the corporate managers and leaders who have workers from other cultures may be addressed by better understanding the differences between cultural values of the home and foreign country. Other arguments of this paper are presented as following propositions:

**Proposition 1:** Incongruence between expatriates' national cultural values and organizational cultural values is likely to unfavorably impact on expatriates' work performance.

**Proposition 2:** Incongruence between expatriates' national cultural values and organizational cultural values is likely to cause expatriates' withdrawal from assignment.

**Proposition 3:** Increasing globalization and competition exerts pressure on organizations to restructure their organizational cultures without considering both local (home) and/or other national (host) cultures.

**Proposition 4:** Adapting only the cultures of successful organizations from industrialized nations and/or not adjusting their organizational cultures at all according to the diverse workforce will create incongruence between employees' national cultural values and organizational cultural values.

**Proposition 5:** Organizations, which try to match their organizational cultural values and national cultural values of their local (home) and/or diverse (host) workforce, have greater likelihood of creating an effective organizational culture.

Denison (1990) defines organizational culture as a system of shared meaning within an organization which influences how employees act (Joiner, 2001). A number of other organizational culture typologies have emerged in the literature. Detert, et.al., (2000) observed and studied the variety of organizational culture definitions in the literature to synthesize a consensus definition, concluding that organizational culture is, "…holistic, historically determined, and socially constructed, and it involves beliefs …" Their 8-dimension consensus definition included the (a) nature of time and time horizon; (b) motivation; (c) stability versus change, innovation, and personal growth; (d) orientation to work, task, and coworkers; (e) isolation versus collaboration and cooperation; (f) control, coordination, and responsibility; and (g) internal or external orientation and focus. Research on the eight dimensions is difficult and uncertain, because of the interrelationships and the absence of consideration of the deeper basic assumptions identified by Schein (1992); he finds that the basic assumptions about reality; truth; time; space; and human nature, activity, and relationships underlie the formation of the organizational culture and ultimately drive outward behavior. It is also defined as a pattern of basic assumptions that the group has learned as it solved its problems of external adaptation and internal integration, such basic assumptions have worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems (Detert, et.al., 2000).

Trompenaars' (1993) organizational culture typology is adopted in this study which is based on the work of Joiner (2001). Trompenaars categorizes organizational culture into four main types based on two dimensions: equity-hierarchy and person-task orientation. According to Trompenaars, four organizational culture types emerge, summarized as follows:

**1)The Family (a power-oriented culture);** This culture is characterized by strong emphasis on the hierarchy and an orientation toward the person. Individuals within this organizational form are expected to perform their tasks as directed by the leader, who may be viewed as the caring parent. Subordinates not only respect the dominant leader or father figure but they also seek guidance and approval.

**2)The Eiffel Tower (a role-oriented culture);** A strong emphasis on the hierarchy and an orientation toward the task characterizes this culture. The "Eiffel Tower" image is intended to symbolize the typical bureaucracy - a tall organization, narrow at the top and wide at the base where roles and tasks are clearly defined and coordinated from the top. Authority is derived from a person's position or role within the organization, not the person per se.

**3)The Guided Missile (a task-oriented culture);** Trompenaars' third type of organizational culture is characterized by a s rong emphasis on equality and an orientation toward the task. The motto for this cultural type is "getting things done". Organization structures, processes and resources are all geared toward achieving the specified task/project goals. Power is derived from expertise rather than the formal hierarchy.

**4)The Incubator (a fulfillment-oriented culture);** This culture is characterized by a strong emphasis on equality as well as an orientation toward the person. Trompenaars states that the purpose of the organization in such a culture is to serve as an incubator for the self-expression and self-fulfillment of its members.

Trompenaars (1993) acknowledges that "pure types" rarely exist; however, he observed a tendency for particular organizational cultural forms to dominate in different national cultures (Joner, 2001)

## National Culture and Organizational Culture Relationship for an Effective Corporate Culture

Most scholars and practitioners have argued that attitudes towards work are a critically important aspect of workplace dynamics and may lead to higher productivity levels on both individual and organizational level of analysis. The attitudes toward work are a great extent affected by the cultural context within which the workers operate (Noe, et.al, 2000). Not much is known or understood about how national culture affects work activities in a given culture. Yet a body of evidence suggests that differences in work values lead to the differences in attitudes towards work in certain national cultures (Peters, et.al., 2000). But these work value differences in countries have not been explored yet. As Trompenaars and Hampden-Turner (1998) proposed, good managers on the intuitive level learn to work with other cultures and seek to reconcile the differences resulting from cultural differences. However, it would be preferable if these differences would first be identified and then analyzed, so that they could be understood and addressed.

Hofstede (2005) contends that the two dimensions, power distance and uncertainty avoidance, have particular relevance for issues in organizational design. Therefore, these two dimensions, only, will be used in developing the relationship among national culture, organizational culture and job-related outcomes for the purpose of the paper.

Power distance refers to the extent to which members of a society accept and expect that power is distributed unequally (Hofstede, 1980). Organizations in high-power distance cultures are characterized by the acceptance of human inequality and individuals show respect for authority that results in a paternalistic work relationship between superior and subordinate. Involvement in the decision-making process is not sought by subordinates nor encouraged by superiors. Indeed, the involvement of subordinates in decision-making processes may be viewed as a sign of poor leadership and result in greater anxiety and confusion for both parties of high-power distance cultures (Joiner, 2001).

Uncertainty avoidance refers to the extent to which members of a society feel threatened by uncertainty or unknown situations (Hofstede, 1980). Organizations in strong uncertainty avoidance cultures are characterized by: a strong need for rules and regulations; greater structuring of organizational activities; employee preference for clear unambiguous instruction from management, less risk-taking; intolerance toward deviant ideas and behaviors; and less individual initiative and responsibility in the workplace (Hofstede, 1980).

From this explanation; the hierarchy focus of the Eiffel Tower organizational culture, operationalized by centralization of decision-making authority, seems congruent with managers, who have high-power distance societal values. Indeed, it is likely that encouraging those managers to increase their involvement in decision making may generate anxiety and lead to lower levels of performance. Such managers tend to prefer and respect a more non-consultative, decisive approach from their superior. Similarly, upper management inculcated with the values of a high-power distance culture, are likely to be reluctant to give up decision-making authority (perceived to be rightly bestowed upon them) to promote a relationship of greater equality in decision making (see Veiga and Yanouzas, 1991).

Similarly, centralization (or low decentralization), a characteristic of the Eiffel Tower organizational culture, tends to fit with managers, who have strong uncertainty avoidance values. Decentralization increases the decision-making authority of subordinate managers. However, fear of making decisions is a characteristic of strong uncertainty avoidance cultures (Hofstede, 2005). Subordinate managers of such cultures would most likely prefer to defer to the certainty of rules, procedures and leader directives, rather than make key decisions themselves and accept responsibility for the decision consequences. An organization culture that emphasizes hierarchy over equity in the form of centralized decision making is likely to be preferred, contributing to high performance for such managers.

Turning to the task focus of the Eiffel Tower organizational culture, operationalized by a high reliance on formalization, such a focus seems to fit with the societal values of high-power distance. Formalization limits the discretion of lower level managers by defining and specifying the boundaries of their behavior and/or actions. Input from the subordinate manager is neither expected nor encouraged. Superior and subordinate managers are likely to feel at ease with this arrangement. Superiors are provided the opportunity to exert and display their authority over subordinates, maintaining their relational power differential. The subordinate is likely to respect the directives from the superior in terms of task execution procedures (Joiner, 2001).

High reliance on formalization, consistent with the task focus of the Eiffel Tower culture, also seems congruent with managers, who have societal values of high uncertainty avoidance. The rule-based nature of formalization techniques, such as standard operating procedures, tends to reduce internal uncertainty by offering clear, unambiguous guidance on task-related matters. Subordinate managers are effectively buffered from uncertainty because they need only to refer to the rules and procedures in order to fulfill their job requirements. Thus high formalization, consistent with the Eiffel Tower organizational culture, is likely to lead higher managerial performance for those managers. Based on the foregoing, there appears to be an alignment between the Eiffel Tower organizational culture (higher centralization and higher reliance on formalization) and the managers, who have societal values of high-power distance and high-uncertainty avoidance. Such an alignment is likely to increase managers performance in an effective workplace environment (Joiner, 2001).

## Implications and Future Suggestions

Evolving issues such as culture, age, gender, sexual orientation and abilities need to be considered as contributing to a more heterogeneous and diverse workforce. Since the publication of Johnston and Packer's 1987 report entitled Workforce 2000, there has been growing interset in the implications on increasingly varied global workforce. Many companies are beginning to implement "diversity awareness" or "valuing cultural differences" programs for their employees to reduce stereotyping, increase cultural sensitivity and to promote a more harmonious and productive workplace (Schneider, 1988; Triandis, 1989; Williams, 1990; Thomas, et.al. 1996; Lorbiecki, 2000; Konrad, et.al, 2006). Traditional methods of employee management that focus on the needs of the one group may no longer provide the "best way" of management. Every culture has developed their own notions of necessary skills for effective management. For example, patricipatory management is often the ideal in a country that espouses democracy, such as the United States; however in Germany, according to the Harzburger model, suboridantes expect the manager to be autocratic, with minimal, mutual decision-making occuring. Managers are challenged to understand the differences that exist among people of diverse backgrounds, including verbal and nonverbal communiaction styles, conflict resolution work habits and their perception of group activities. Diverse employees have different needs and motivations as compared to the "typical" worker concept under one culture; for example, an Asian employee may prefer a job without conflict in a stable environment, or for a working parent a motivating factor for employment may be child daycare and for an elderly worker, it may be low stres job. The challenge for the companies today is to effectively coordinate their heteregeneous workforce to meet the demands of specifically globalizing world (Harris, 1995) .

## Conclusion

The role of national culture in organizations and managing diversity has been a subject area in the business world at least 30 years (Friedman, et.al., 2005) Understanding and knowing how national cultural differences influence how employees act in a business organization is essential to leaders/managers within that organization because it allows them to harness diversity and have a diverse employees with diverse perspectives who contribute to the organization's success.

Diversity addresses those human qualities that are different from our own and outside the groups to which we belong, yet are present in other individuals and groups. Diversity is defined from an objective point of view as the physical and cultural differences that encompass the spectrum of human diversity, from a subjective view, diversity is “the otherness” or human qualities that are different from our own group as well as different groups (Clifford, 2007). Cultural diversity, then, mirrors the unique sets of beliefs, attitudes, values and expectations as well as symbols, customs, language, and behaviors that individuals possess by virtue of sharing some common characteristics with others (Adler, 2002; Cox & Blake, 1991; DeSensi, 1994; Hofstede, 1980; Trompenaars & Hampden-Turner, 1998). In the process of managing diversity, the goal is to create an organizational climate that accepts and promotes the potential that each individual employee brings to a heteregeneous workplace. So the corporations should take this into consideration while craeting a corporate culture for their diverse and mobile workforce for a harmonious workplace.

## REFERENCES

Adler, N.J. (2002), International Dimensions of Organizational Behavior, Belmont, CA: Wadsworth.

Adler, Nancy J. and Jelinek, Mariann (1986), ‘Is “Organization Culture” Culture Bound?’, Human Resource Management, Vol. 25, Iss. 1; p. 73.

Albert, S., B. E. Ashforth and J. E. Dutton (2000). ‘Organizational identity and identification: charting new waters and building new bridges’, Academy of Management Review, 25, pp. 13–17.

Al-Jafary, A. and Hollingsworth, A. T.(1983), ‘An Exploratory Study of Managerial Practices in the Arabian Gulf Region’, Journal of International Business Studies, Vol. 14, Iss. 2; p. 143.

Alvesson, M. (1990). ‘Organization: from substance to image?’, Organization Studies, 11, pp. 373–394.

Alvesson, M. and H. Willmott (2002). ‘Identity regulation as organizational control: Producing the appropriate individual’, Journal of Management Studies, 39(5), pp. 619–644.

Brickson, S. (2000). ‘The impact of identity orientation on individual and organizational outcomes in demographically diverse settings’, Academy of Management Review, 25, pp. 82–101.

Brickson, S. (2005). ‘Organizational identity orientation: forging a link between organizational identity and organizations’ relations with stakeholders’, Administrative Science Quarterly, 50, pp. 576–609.

Brown, A. (2001). ‘Organization studies and identity: towards a new agenda’, Human Relations, 54(1), pp. 113–121.

Brown, A. D. (2006). ‘A narrative approach to collective identities’, Journal of Management Studies, 43(4), pp.731–753.

Clifford, B. Mark (2007), A Qualitative Approach to Understanding International Basketball Players’ National Culture and Perceived Fit In The NBA, Ph.D. dissertation, The University of New Mexico.

Cox, Taylor H., and Jr., Blake, Stacy (1991), ‘Managing Cultural Diversity: Implications for Organizational Competitiveness’, The Academy of Management Executive, Vol. 5, Iss. 3; p. 45

DeSensi, J.T., (1995), Understanding multiculturalism and valuing diversity: A Theorteical Perspective, Quest, Vol. 47, pp. 34-43.

Detert, James R, Schroeder, Roger G., and Mauriel , John J (2000), ‘A framework for linking culture and improvement initiatives in organizations’, The Academy of Management Review, Vol. 25, Iss. 4; p. 850.

Dulnik, Agata, Cross-National Differences in The Work Values of Employees of a US-based Multi-National Corporation: A Comparative Study of the United States, Poland, and Mexico, Dissertation Submitted to The Graduate School of Education and Human Development of The George Washington University, 2004.

Elizur, D., Borg, I., Hunt, R., & Beck, I.M. (1991). The structure of work values: A cross cultural comparison. *Journal of Organizational Behavior*, *12*, 21–38.

England, George W., (1983), '<u>Japanese and American Management: Theory Z and Beyond</u>', Journal of International Business Studies, Vol. 14, Iss. 2; p. 131.

Friedman, J.V. and Antal , A.B., (2005), '<u>Negotiating Reality: A Theory of Action Approach to Intercultural Competence</u>', Management Learning, Vol. 36, Iss. 1; p. 69

Gioia, D. A., M. Schultz and K. Corley (2000). 'Organizational identity, image and adaptive instability', Academy of Management Review, 25, pp. 63–82.

Griffin, R. (1999), Management, Boston; Houghton Mifflin Co.

Harris, Polifko, Karin, (1995), The Influence of National Culture on Work Related Values and Job Satisfaction Between American and Fillipino Registered Nurses, Dissertation submitted to University of North Carolina at Charlotte.

Haslam, S. Alexander, Eggins, Rachael A, J Reynolds, Katherine (2003), '<u>The ASPIRe model: Actualizing social and personal identity resources to enhance organizational outcomes</u>', Journal of Occupational and Organizational Psychology, Vol. 76; p. 83.

Hatch, M. J. and M. Schultz (2002), "<u>The dynamics of organizational identity</u>", Human Relations, New York: Aug 2002. Vol. 55, Iss. 8; p. 989

Hatch, M. J. and M. Schultz (1997). "Relations between organizational culture, identity and image", European Journal of Marketing, 31, pp. 356–365.

Hatch, M. J. and M. Schultz (2002). 'The dynamics of organizational identity', Human Relations, 55(8), pp. 989–1018.

Hofstede G. and Hofstede G. Jan, (2005), 'Cultures and Organizations: Software of The Mind', 2nd ed., McGraw-Hill, 2005.

Hofstede, G..(1985), 'The Interaction Between National and Organizational Value Systems', Journal of Management Studies, 22 (4), pp. 347-357.

Hofstede, G. (1984), The cultural relativity of the quality of life concept, Academy of Management Review, 9, 389–398.

Hofstede, G. (1980), Culture's Consequences: International Differences in Work-Related Values, Beverly Hills, CA, Sage.

Hofstede, G., Neuijen, B., Ohavy, D.D., & Sanders, G. (1990). Measuring organizational cultures: A qualitative and quantitative study across twenty cases. Administrative Science Quarterly, 35, 286–316.

Johnston, W.B., and Packer A.E., (1987), 'Workforce 2000: Work and Workers for the Twenty-First Century', DIANE Publishing, 1987.

Joiner, Therese A. (2001), 'The Influence of National Culture and Organizational Culture Alignment on Job Stress and Performance: Evidence from Greece', Journal of Managerial Psychology, Bradford, Vol.16, Iss.3, pg.229.

Konrad, A.M., Prasad, P. And Pringle, J.K., Ed.s. (2006), 'Handbook of Workplace Diversity', Sage Publications.

Lorbiecki, A. and G. Jack (2000). 'Critical turns in the evolution of diversity management', British Journal of Management, 11, pp. 17–31.

Mintzberg, Henry, (1990), '<u>The Design School: Reconsidering The Basic Premises Of Stra</u>tegic Management', Strategic Management Journal, Vol. 11, Iss. 3; p. 171.

Noe, R. A., Hollenbeck J.R., Gerhart B., and Wright P. M, (2000), 'Human resource management, gaining a competitive advantage', Irwin.

Peters L.H., Greer C.R., and Youngblood S. A., Ed.s (1999), The Blackwell Encyclopedic Dictionary of Human Resource Management.

Pratt, M. G. and P. O. Foreman (2000). 'Classifying managerial responses to multiple organizational identities', Academy of Management Review, 25, pp. 18–42.

Ralston, D.A, Holt, D.H, Terpstra, R.H, Cheng, Yu Kai (2008), "The impact of national culture and economic ideology on managerial work values: A study of the United States, Russia, Japan, and China, Journal of International Business Studies", Vol. 39, pp. 8-26.

Ravasi, D. and M. Schultz (2006), 'Responding to organizational identity threats: exploring the role of organizational culture', Academy of Management Journal, Vol. 49, Iss.3, pp. 433–458.

Rokeach, M.: 1971, 'Long-Range Experimental Modification of Values, Attitudes, and Behavior', American Psychologist 26, 453-459.

Schneider, S.C. (1988). National versus corporate culture: Implications for human resource management. *Human Resource Management*, *27*, 231–246.

Thomas, D. A. and R. J. Ely (1996). 'Making differences matter: a new paradigm for diversity management', Harvard Business Review, September–October, pp. 79–90.

Triandis, H.C. (1989). The self and social behavior in differing cultural contexts. *Psychological Review*, *96*, 506–520.

Trompenaars, F. and Hampden-Turner, C. (1998), Riding the waves of culture: understanding cultural diversity in global business, 2nd Ed., McGraw-Hill.

Veiga,J.and Yanouzas, J. (1991), 'Differences between American and Greek managers in giving up control', Organization Studies, pp. 95-108.

Weech, W. A., (1999), 'The relationship between national culture and foreign service managerial job requirements' dissertation Ed.D., The George Washington University.

Whetten, D. (2006), "Albert and Whetten Revisited: Strengthening the Concept of Organizational Identity", Journal of Management Inquiry, Thousand Oaks, Vol.15, Iss. 3, p. 219.

Williams, M., (1990), Managing work-place diversity…the wave of the 90's, IABC Communication World, Vol.7, Iss.1, pp.16-19.

Yukl, G. (1994), Leadership in Organizations, 3rd ed., Englewood Cliffs, NJ, Prentice Hall.

# THE IMPACT OF EMPOWERMENT AND QUALITY CULTURE ON JOB SATISFACTION

**Hakan Kitapçı**
**Gebze Institute of Technology, Turkey**
**Metin Ateş**
**Marmara University, Turkey**
**Sultan Süleyman Ökten**
**Gebze Institute of Technology, Turkey**

## ABSTRACT

*The purpose of this study is to examine and compare the effects of dimensions empowerment and quality culture on job satisfaction. Data obtained from 333 employees in private Sector Company in Turkey was used to examine the hypothesized relationships among study variables. Principal factors with Varimax rotation were used for each variable to demonstrate the factor structure. We used the Cronbach's Alpha to estimate reliability scales. Then data were analyzed by correlation analysis and separate regression models. The results revealed that three dimensions of perceptions of empowerment are positively and significantly related to quality culture. The results also suggested that, one of the dimensions of empowerment and quality culture are positively and significantly related to job satisfaction.*

## KEYWORDS

*Empowerment, Quality Culture, Job satisfaction*

## INTRODUCTION

Total Quality culture has enabled self managing teams, free information sharing between managers and employees and feedback. Employees have been included more in decision-making mechanism and they have acquired more opportunities in reaching the organizational resources easily and controlling them to attain their goals. The efforts of continuous education and improvements have become more crucial in order to develop employees' knowledge and experiences. Empowerment could be applied more easily by satisfying many requirements of the concept of empowerment. The concept of empowerment, studied as a motivational phenomenon, has been frequently related to the terms like job satisfaction in the literature (Ugboro and Obeng, 2000, Liden and Sparrowe, 2000, Osborne, 2002, Bordin, Bartram and Casimir, 2007). The dimensions of empowerment and its impact on quality culture could enable managers aiming to applying empowerment to motivate employees more effectively while solving quality problems.

## EMPOWERMENT

The concept of Empowerment is a term beyond "distributing responsibility", "participative management" or another definition of management. Empowering employees enable them to become more powerful (Saeman, 1992, s.189). However, this reinforcement does not mean strengthening in organization hierarchy or in a material sense. It is rather strengthening through personal development, making the individual more informed, more self confidence, triggering their ability to establish more constructive and good relations and enabling them to create their own environments

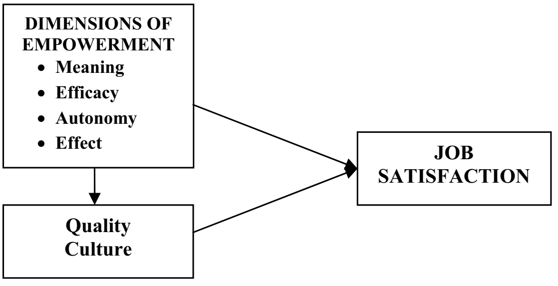
## THE RELATIONSHIP BETWEEN THE DIMENSIONS OF EMPOWERMENT AND JOB SATISFACTION

Successful Total Quality Management programs have revealed that empowerment increases level of job satisfaction, since easier accessibility to information related to the strategies, values and mission of organizations has encouraged individuals to involve in the process of total quality process and thus, level of job satisfaction could be enhanced (Ugboro and Obeng, 2000, p.254). Another finding asserted that empowerment backed up job satisfaction through employee involvement, lower organizational levels communication, convenience of providing related information about the job requirements , promotion opportunities, development opportunities and convenience of the related information about the organization's values, vision and strategies (Ugboro and Obeng, 2000, s.263). The reward and identification systems of the organization, adaptation to a quality culture and continuous improvement-oriented education and improvement programs as components of empowerment have positive impacts on job satisfaction (Ugboro and Obeng, 2000, s.265). Thomas and Dunkerly claimed in their study conducted in England that lower levels of empowerment led to decreases in the level of job satisfaction. Meaning, being one of the four components of empowerment, has been proven as the most related dimension to job satisfaction according to the study carried out by Liden et al(2000). Furthermore, they have asserted that the other three dimensions have also positive effects on job satisfaction. Through their study, they have revealed that employees have experienced more job satisfaction when they could involve more in decision making process. Their study has also showed that individuals having more control power and autonomy could be more pleased in terms of their jobs since the individuals since they could adopt the successes much more. Lastly, individuals having self-efficacy, self confidence for achieving something, have a higher level of job satisfaction when compared to the ones experiencing the fear of failure (Liden and Sparrowe, 2000, s.410). Herzberg, Mausner and Snyderman (1950) noted that one's job satisfaction level depended on the meaningful job requirements and the opportunities of recognition. Hackman and Oldham has argued that job meaningfulness is a crucial determinant of job satisfaction. Employees perceiving their jobs important and valuable have higher levels of job satisfaction (Osborne, 2002, p.45). The study of Spreitzer conducted in two organizations revealed that the "meaning" dimension of empowerment was related to job satisfaction. Bordin, Bertram and Casimir acknowledged job satisfaction as one of the most significant outcomes in their study. According to their research, the meaning dimension of empowerment is crucial for job satisfaction as individuals could only be satisfied when they feel that they are subjected to a meaningful job (Spreitzer, 1997). Spreitzer also asserted that the autonomy dimension of empowerment is a psychological need and this dimension provides internal motivation. Related to the effect dimension of empowerment Liden (2000) stated: "Individuals perceive themselves as the part of the job when they believe that they could affect the work outcomes; thus, they could be more satisfied". In accordance with these arguments, individuals having the feeling of self efficacy have acquired more satisfaction (Bordin, Bartram and Casimir, 2007, s.37). Ugboro and Obeng claimed increased level of job satisfaction thanks to empowerment could facilitate top management efforts and thereby employees could become more committed to customer satisfaction, one of the main goals of Total Quality Culture (Ugboro and Obeng, 2000, s.247).

## THE RELATIONSHIP BETWEEN EMPOWERMENT AND QUALITY CULTURE

In Total Quality Management Literature, employee involvement and empowerment are defined as the critic elements of Total Quality Management Program. Lawler (1994) identified empowerment as one of the most significant principle. Thomas and Velthouse (1990) defined empowerment as a unique task motivation reflecting individuals' orientation towards their job and role and coming out through four cognitive concepts. In this study, intrinsic task motivation is accepted as the positive experiences acquired thanks to a motivating and satisfying job. In harmony with McCleland's claims, managers having the perception of quality culture could enable individuals to perceive problems more quickly and reach the necessary resources more easily by means of the synergy supported by collaboration through applying personnel empowerment (McClelland, 1975).

**Figure 1:** Theoretical research model



# METHODOLOGY AND FINDINGS

## Measures, Sample, Demographic Characteristics

The questions related to the dimensions of empowerment have been taken from the study of Spreitzer (1995), The quality culture questions are constructed by means of Manley's(1998) study and Detert, Schroeder Cudeck's (2003) study and lastly, the questions about job satisfaction are taken from Schwepker's(2001) study. In this study, all items were measured on a five point Likert-type scale where 1 = strongly disagree and 5= strongly agree.

The data for this study were collected from Private Sector Company. The questionnaire was answered by 343 employees, ten of them were excluded and totally 333 questionnaires are analyzed. SPSS 10.0 was used in data analysis. The analysis are respectively the demographic characteristics of the employees answering the questionnaires and frequency tables, factor analysis, reliability tests, correlation analysis including means and standard deviations and regression analysis to test the research hypothesis. 73 percent of the employees answering the questionnaire were male, 53 percent were married, age average is 27 (σ=5,3) and 49 percent of them graduated from a university (Table 1).

**Table 1:** Demographics of respondents

| | *N* | *%* | | *N* | *%* |
|---|---|---|---|---|---|
| ***Marital status*** | | | ***Gender*** | | |
| Single | 138 | 41 | Male | 244 | 73 |
| Married | 176 | 53 | Female | 87 | 26 |
| | | | | | |
| ***Education*** | | | ***Position*** | | |
| Elementary | 217 | 44 | Blue-collar worker | 159 | 48 |
| College | 95 | 19 | Office worker | 119 | 36 |
| University | 245 | 49 | Middle- level manager | 53 | 16 |
| Graduate level | 34 | 7 | | | |

## Factor Analysis

All scale items were submitted to exploratory factor analysis the best fit of the data was obtained with a principal factor analysis with a varimax rotation. While applying factor analysis, independent and dependent variables are analyzed together, the dimensions of empowerment, job satisfaction and quality culture are included in one factor analysis at once. The results of factor analysis and eigenvalues are shown in the tables below

**Table 2:** Factor Loadings and Eigenvalues of Variables

| Item Number | Quality Culture | Job Satisfaction |
|---|---|---|
| 15 | | ,807 |
| 16 | | ,806 |
| 17 | | ,708 |
| 1 | ,631 | |
| 2 | ,693 | |
| 3 | ,694 | |
| 4 | ,719 | |
| 5 | ,428 | |
| 6 | ,714 | |
| 7 | ,753 | |
| 8 | ,706 | |
| 9 | ,415 | |
| 10 | ,646 | |
| 11 | ,674 | |
| 12 | ,631 | |
| 13 | | ,711 |
| 14 | | ,662 |

| Item Number | Quality Culture | Job Satisfaction | Impact | Competence | Meaning | Self-Determination |
|---|---|---|---|---|---|---|
| 18 | | | ,833 | | | |
| 19 | | | ,871 | | | |
| 20 | | | ,857 | | | |
| 21 | | | | ,828 | | |
| 22 | | | | ,876 | | |
| 23 | | | | ,785 | | |
| 24 | | | | | ,807 | |
| 25 | | | | | ,834 | |
| 26 | | | | | ,718 | |
| 27 | | | | | | ,748 |
| 28 | | | | | | ,775 |
| 29 | | | | | | ,772 |

| Component | Initial Eigenvalues | | | Rotation Sums of Squared Loadings | | |
|---|---|---|---|---|---|---|
| | Total | % of Variance | Cumulative % | Total | % of Variance | Cumulative % |

| | | | | | | |
|---|---|---|---|---|---|---|
| Quality Culture | 8,410 | 29,000 | 29,000 | 5,488 | 18,923 | 18,923 |
| Job Satisfaction | 3,102 | 10,695 | 39,695 | 3,288 | 11,337 | 30,260 |
| Impact | 2,471 | 8,520 | 48,216 | 2,913 | 10,044 | 40,304 |
| Competence | 1,787 | 6,162 | 54,378 | 2,352 | 8,110 | 48,414 |
| Meaning | 1,411 | 4,865 | 59,243 | 2,209 | 7,616 | 56,030 |
| Self-Determination | 1,182 | 4,075 | 63,318 | 2,113 | 7,288 | 63,318 |

## The Correlation Coefficients, Means, Alphas And Standard Deviation Values Of The Variables

Reliability, in short, is the result of the internal consistency considering the average relationships among the questions included in a variable (Kerlinger, 1986). Table 3 indicates that alpha values are found between 0,77 and 0,93 and this result shows that the variables have internal consistency. In other words, according to Cronbach alpha 0,70 coefficient is sufficient for internal consistency. Means, standard deviations, reliabilities, and correlations among all scales used in the analyses are shown in Table 3.

**Table 3:** The Correlations, Means, Alphas and Standard Deviations belong to the variables

| | **α** | **μ** | **σ** | **Job Satisfaction** | **Meaning** | **Competence** | **Self-determination** | **Impact** |
|---|---|---|---|---|---|---|---|---|
| **Job Satisfaction** | 0,85 | 3,67 | ,87 | | | | | |
| **Meaning** | 0,80 | 3,87 | ,82 | ,344(**) | | | | |
| **Competence** | 0,82 | 4,24 | ,67 | ,146(**) | ,372(**) | | | |
| **Self-determination** | 0,77 | 3,81 | ,79 | ,201(**) | ,259(**) | ,303(**) | | |
| **Impact** | 0,92 | 3,24 | 1,03 | ,251(**) | ,169(**) | ,009 | ,406(**) | |
| **Quality Culture** | 0,93 | 3,67 | ,79 | ,487(**) | ,303(**) | ,097(*) | ,302(**) | ,443(**) |

***P<0,05; **P<0,01***

## Regression Analysis

We tested the hypotheses with separate multiple regression analyses. The first analysis included meaning, efficacy, autonomy and effect as independents. The second regression model was developed to test the effects of these dimensions of empowerment quality culture. The third model included dimensions of empowerment and quality culture as independent variables. As seen below, the effects of dimensions of empowerment on job satisfaction and quality culture were tested with three multiple regression models and all models were found statistically significant ($p<0.01$). We predicted that higher scores on measures of perceptions of empowerment would be related to job satisfaction and quality culture. In model 1, meaning was related to job satisfaction. In model 2, meaning, self-determination and impact were strongly related to quality culture. Third model examined the effects of dimensions of empowerment and quality culture on job satisfaction and revealed that meaning and quality culture are positively related to job satisfaction ($p<0.01$) (Table 4).

**Table 4:** Regression Models

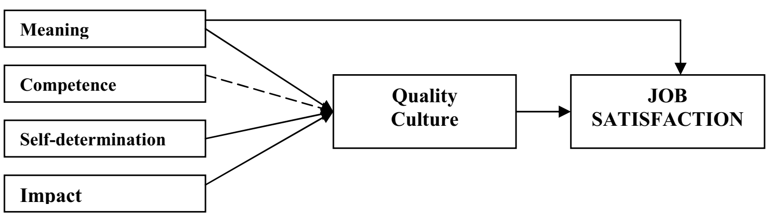
| | **Model 1 (Job Satisfaction)** | | | **Model 2 (Quality Culture)** | | | **Model 3 (Job Satisfaction)** | | |
|---|---|---|---|---|---|---|---|---|---|
| | ***β*** | ***t*** | ***Sig.*** | ***β*** | ***t*** | ***Sig.*** | ***β*** | ***t*** | ***Sig.*** |
| **Meaning** | ,177 | 2,902 | **,004**** | ,122 | 2,082 | **,038*** | ,150 | 2,487 | **,013*** |
| **Competence** | ,107 | 1,677 | ,094 | ,112 | 1,839 | ,067 | ,081 | 1,298 | ,195 |
| **Self-determination** | ,018 | ,293 | ,770 | ,125 | 2,122 | **,035*** | -,011 | -,174 | ,862 |
| **Impact** | ,072 | 1,258 | ,209 | ,236 | 4,323 | **,000**** | ,018 | ,311 | ,756 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Quality Culture** | - | - | - | - | - | - | ,229 | 4,054 | **,000**** |
| | ***F**=6,335* | | | ***F**=14,698* | | | **F**= *8,594* | | |
| | ***R²**=,072* | | | ***R²**=,152* | | | ***R²**=,116* | | |
| | ***Sig.**=,000* | | | ***Sig.**=,000* | | | ***Sig**=,000** | | |

***P<0,05; **P<0,01***

Model 2 revealed that meaning($\beta$=0.122, $p<0.05$), self-determination ($\beta$=0.125, $p<0.05$) and impact ($\beta$=0.236, $p<0.01$) are positively related to quality culture however it is found that impact is more strongly related to quality culture than the others. After quality culture was added to the model in model 3, meaning ($\beta$=0.150, $p<0.05$) and quality culture ($\beta$=0.428, $p<0.01$) were still significant. Besides Self-determination and Impact lost its statistical significance (see Table 4). This implies a mediation relationship (Baron and Kenny, 1986) that the relationship between dimensions of empowerment and job satisfaction is fully mediated by quality culture. Thus based on the regression analysis, the following empirical model has been developed (Figure 2).

**Figure 2:** Empirical research model




# DISCUSSION AND CONCLUSION

This study is carried out to reveal the effects of the dimensions of empowerment on job satisfaction and the changes the quality culture leading on these effects.

According to our analysis, a positive relationship is found between the meaning dimension of empowerment and job satisfaction. In empirical studies, meaning has received strong support as being positively associated with job satisfaction. In Spreitzer and colleagues (1997) study, meaning was related to work satisfaction and explained the most variance in work satisfaction (Spreitzer et al., 1997). Carless (2004) used a sample of customer service employees to study empowerment and job satisfaction. She found meaning to be significantly related to present job satisfaction. Liden and colleagues (2000) studied employees in lower levels of several major divisions of a large service organization. They also found the meaning cognition of psychological empowerment to have a significant relationship with work (Liden et al., 2000). Meaning can be defined as a consistency between an individual's beliefs, values and behaviours and the requirements of the job. This consistency is the significance of the job for the individual. The more harmony between the employee's beliefs, values and the requirements of the job has perceived, the more importance is given to the job by the employee. In other words, the consistency between the requirements of the conducted work and the individual's beliefs, values and behaviours is the indicator of the meaningfulness of the job for the employee (Spreitzer, 1995).

The dimensions of empowerment which was meaning, self-determination and impact have impacts on quality culture. The sense of quality culture encourages empowerment of employees to improve work processes better and satisfy costumer efficiently.

At first, individuals should believe that they are important for the organization to feel themselves effective. If the top management does not give much responsibility to the employees and provide them the opportunities to carry out their own works, they overshadow the emergence of individuals' creativity. Taking responsibility for conducting one's own job increases the individual's self confidence. The monopoly of decision making mechanisms owned by managers decreases the employee's motivation level. The individual's creativity and innovativeness could be increased through expressing themselves without hesitation related to the decisions about the work. In Japanese culture, being the leader in the quality applications, individuals decide on their own related to their own work processes and they have the required authorities to improve the quality and performance (Zhao, 1993). Especially, the meaning and effect dimensions of the empowerment have impacts on job satisfaction, the employees could adopt the works and they really effect the department while realizing the work and therefore their satisfaction levels are increased.

Empowerment is known to be one of the most crucial principles of Total Quality Management. That's why, empowerment is expected to be more applicable in the organizations where Total quality management prevails. Among the dimensions of the empowerment, meaning, self-determination and impact have impacts on quality culture. These dimensions foster a better perception of quality culture (Table 4). The strongest relationships were found between quality culture and job satisfaction. The relationship between quality culture and job satisfaction is consistent with the Elçi et.al., (2007). Furthermore, recent research also suggests a strong positive relationship between, quality culture and employees' job satisfaction (Ugboro & Obeng, 2000). Blackburn & Rosen (1993) reported that organizations with successful TQM programs, especially those that have won the Malcolm Baldrige Quality Award, have employees with higher job satisfaction. Moreover, research yielded those highly motivated employees who are satisfied with their jobs showed higher performance in their jobs as a result of their perception of the emphasis that the organizational culture places on quality (Schlesinger & Heskett, 1991; Schlesinger & Zomitsky, 1991). Managers should aim to establish more flexible working environments instead of forced imperatives and enable the employees to acquire more responsibility related to their own works. Thus, individuals could adopt their jobs better and become more committed to the organization.

The limitations of this study include the use of a very specific sample of employees. It might be the case that the findings of this study may not be generalisable to employees in different industries. In spite of these limitations, the results of this study are present. First, the findings of this study have shown that meaning, self-determination and impact are positively related to quality culture. Second, the findings reveal that quality culture and meaning can increase job satisfaction.

# REFERENCES

Baron, R. M., and Kenny, D. A. (1986). The moderator-mediator distinction in social psychological research: conceptual, strategic, and statistical considerations. *Journal of Personality and Social Psychology*, 51, 1173-1182.

Blackburn, R. & Rosen, B. (1993) Total quality and human resources management: lessons learned from Baldridge award-winning companies, *Academy of Management Executive*, 7(3), pp. 49–66.

Bordin C., Bartram T., Casimir G., (2007) "The antecedents and consequences of psychological empowerment among Singaporean IT employees", *Management Research News*, Vol.30, No.1, s.37

Carless, S. A. (2004). Does psychological empowerment mediate the relationship between psychological climate and job satisfaction? Journal of Business and Psychology, 18(4), 405-425.

Detert, J.R., Schroeder, R.G., Cudeck, R., (2003), "The measurement of Quality Management Culture in Schools: Development and Validation of the SQMCS", *Journal of Operation Management*, Vol.21, p.307-328

Elçi, M., Kitapçı, H., & Ertürk, A., (2007) Effects of Quality Culture and Corporate Ethical Values on Employee Work Attitudes and Job Performance in Turkey: An Integrative Approach, *Total Quality Management*, Vol. 18, No. 3, 285–302.

Kerlinger, F.N., (1986). Foundations of Behavioral Research (3rd ed.). Forth Worth, TX: Holt Rinehart and Winston, Inc.

Lawler E. E., (1994), "Total Quality Management and Employee Involvement: Are They Compatible?", *Academy of Management Executive* 8 (1), 68-76.

Liden, R.C., Wayne, S.J. & Sparrowe, R.T.(2000), "An Examination of the Mediating Role of Psychological Empowerment on the Relations Between the Job, Interpersonal Relationships, and Work Outcomes", *Journal of Applied Psychology*, Vol:85 No:3,407-416

Manley, J.E., (1998) "Symbol, Ritual, and Doctrine: The Cultural 'Tool Kit' of TQM*", Journal of Quality Management*, Vol.3, No:2, pp.175-191

McClelland, D. C. (1975). Power: The inner experience. New York: Irvington

Osborne, J.S., Components of Empowerment and How They Differentially Relate to Employee Job Satisfaction, Organizational Commitment, and Intent to Leave the Job, Peabody College of Vanderbilt University, May 2002

Saeman, R. (1992), "The environment and The Need for New Technology: Empowerment and Ethical Values", *The Colombia Journal of World Business*, Vol.17,Fall-Winter,s.186-193

Schlesinger, L. A. & Heskett, J. (1991) Breaking the cycle of failure in services, *Sloan Management Review*, 32(3), pp. 17–28.

Schlesinger, L. A. & Zomitsky, J. (1991) Job satisfaction, service capability and customer satisfaction: an examination of linkages and management implications, *Human Resource Planning*, 14(2), pp. 141–149.

Schwepker, C.H. (2001), "Ethical Climate's relationship to job satisfaction, organizational commitment, and turnover intention in the salesforce", *Journal of Business Research*, Vol.54, 39-52

Spreitzer, G. M., Kizilos, M. A., & Nason, S. W. (1997). A Dimensional Analysis of the Relationship Between Psychological Empowerment and Effectiveness, Satisfaction, and Strain. Journal of Management, 23(5), 679-705.

Spreitzer, Gretchen M. (1995), "Psychological Empowerment in the Workplace: Dimensions, Measurement, and Validation", *The Academy of Management Journal*, Vol.38, No.5

Thomas, K.W. and Velthouse, B.A. (1990), "Cognitive Elements of Empowerment: an 'interpretive model' of intrinsic task motivation" *Academy of Management Review* 15: 666-681.

Ugboro, I. O. & Obeng, K. (2000) Top management leadership, employee empowerment, job satisfaction, and customer satisfaction in TQM organizations: an empirical study, *Journal of Quality Management*, 5, pp. 247–272.

Ugboro, Isaiah O. & Obeng, Kofi (2000) "Top management leadership, employee empowerment, job satisfaction, and customer satisfaction in TQM organizations: an empirical study", *Journal of Quality Management*,5, 247-272

Zhao B., (1993), "How Do Japanese Manage Total Quality?" Association of Business Studies, Best Paper Proceedings, 153-160.

# RE–DISCOVERY OF THE CIVIL SOCIETY ORGANIZATIONS IN THE WORLD, AND TURKEY: A FIELDWORK IN ÜSKÜDAR, A DISTRICT IN İSTANBUL

**Süleyman Özdemir**
**İstanbul University, Turkey**

**Zeki Parlak**
**Marmara University, Turkey**

## ABSTRACT

*The post–1980 era has witnessed the widespread transformations in the economic and political realms of the social life at the global level. The expansion of globalization, neo–liberalism and participative democracy has resulted in the increasing importance of the civil society organisations in the last there decades. The state has withdrawn from in the economic and social areas. While the economy has been left to the market forces, new actors enter the scene to provide social welfare services. Consequently, the civil society organisations were re–discovered as the abiding provider of the social aids. Thus, it may not be incorrect to name this century as the century of the civil society.*

*The civil society organisations are now considered as extremely significant institutions of the modern society as the new provider of social services. A new division of labour has been advanced between the state, municipals, market and the civil society organisations. The state has formed partnership with the CSOs and prefers purchasing services from the civil society organisations rather than producing them. The process has been expanding in since the late 1970s and has come to constitute a significant part of welfare mixes in many countries. In many developed nations, particularly the USA and UK, the legal system and the administrative reforms enabled the state to maintain the responsibility for financing and auditing the social welfare services while transferring the responsibility for the provisions of these services to the civil society organisations and private sectors.*

*In contrast to the developed nations, the civil society organisations are extremely weak in Turkey. Despite the promotion and expansion of their role in the social policy area at the global level, the Turkish civil society organisations do not seem to have gained any impetus. Neither the state nor the civil society organisations have any intention to alter their entrenched attitudes. The state has distrusted them and hostile attitude towards that civil society organisation which are not under its control. The civil society organisations, on the other hand, have no desire to change and undertake any major responsibility for social services.*

*This paper seeks to investigate the Turkish civil society organisations' approaches to the social policy and a new role regarding the provision of the social policy. The research is based on the findings of a fieldwork carried out in Üsküdar, Istanbul. The paper argues that although neither the state nor the civil society organisations have altered their attitudes in line with those in the developed world, Turkey's accession to the EU will eventually transform the hostile attitude of the state towards the civil society and give rise to the growth of the civil society in Turkey.*

***Keywords:*** *Civil Society Organizations (CSOs), Non–Profit Organizations (NPOs), Non–Governmental Organizations (NGOs), Third Sector, Social Policy, State–NGOs Relationship, Üsküdar District (İstanbul) Field Survey.*

## INTRODUCTION

The 1980s have witnessed major transformations in the economic, political and social realms. With the collapse of the Post–War order, the Western capitalism moved to a new stage. With ascendency of the new–liberal economic policies, while the state involvement in the economy was undermined, the expansion of the welfare state came to the end. For the neo–liberals, the state involvement in the economy created market inefficiencies and prevented optimum allocation of resources. Hence, it is more rational for the state to withdraw from the economy and stop providing social welfare services. The social welfare services must be provided by civil society organizations or the private sector (1) *(Pierson, 2001: 309).* This resulted in the re–discovery of the role of the civil society organizations as the actors in providing social services in the developed economies. A spectacular expansion of their role and activities of the civil society organizations in the provision of social services have been observed. The number of the civil society organizations has also mushroomed.

The post 1929 crisis witnessed a period in which the role of the state in the economy and in the provision of social services was rapidly expanded. Nevertheless, with the crisis of the 1970s the state involvement in those areas came to be questioned. A new area was launched by the adaption of neo–liberal economic policies, demanding minimum state interference in the economic and social realms in the late 1970s *(Özdemir, 2007: 254–255).* Consequently, the discourse that the civil society organizations and waning the state have dominated the economic, political and social agendas in the world *(Özbek, 2002: 26).*

This paper seeks to investigate the Turkish CSOs' approaches to the social policy and a new role regarding the provision of the social policy on the basis of a research carried out in Üsküdar, Istanbul. The paper argues that although neither the state nor the civil society organisations have altered their attitudes in line with those in the world. Turkey's accession to the EU will eventually transform the hostile attitude of the state towards the civil society and give rise to the growth of the civil society in Turkey.

# I. THE CONCEPT AND DESCRIPTION OF CIVIL SOCIETY ORGANIZATIONS

## A. The Confusion over the Concept of Civil Society

Civil society organizations (CSOs) are composed of a wide range of different organizations such as small local associations, large professional organizations and foundations. A number of different terms are currently used to indicate the civil society in the literature. Some widely used terms include civil society organizations, non–profit organizations, non–profit sector, non–governmental organizations, non–governmental sectors, philanthropic organizations, charitable organizations, third sector, voluntary organizations, private voluntary organizations, not–for–profit organizations, independent sector, tax–exempt organizations and social movements *(Uslu, 1999: 24).*

In the Turkish literature on this sort of civil organizations, although there is disagreement whether some of these organizations could be considered as civil society or not, the term civil society organizations is used to point out followings: foundations, associations, chambers, cooperatives, clubs, and platforms, and non–governmental organizations and third sector. On the other hand, some different terms such as community, society, order, guild and foundations were employed in the past to express the civil society organizations *(ACOC, 2004).*

The term "non–profit organizations" is preferred in the developed world. This term is extensively used in English literature. Nevertheless, the term civil society organizations will be used in this article. This is because this term has wider in scope, is also well known and commonly used in the academic circles, the political discussions and in the daily life in Turkey.

## B. The Concept of Civil Society Organizations

The concept of CSOs has a wider framework and usually tends to include most of the other terms given above. The CSO is based on the voluntariness principle and is wrought by philanthropy and social aims. It is independent of the state, constitutes a third sector along with the public and private ones. Although located in the private sector, it is quite distinct from it in terms of its structure.

Lester Salamon *(1999: 10–11),* who has written widely on the civil society organizations, describes the civil society organizations as non–profit organizations and non–profit sector in his book and indicate that they have six basic features in common.

- First all these organizations have managed to become institutionalized one way or another. Informal and temporary gathering of people cannot be regarded within the scope of non–profit establishments.

- Second, these organizations must operate in the "private sector". Thus, they must be independent of the state. Nevertheless, this point does not mean that these organizations may not receive support from the state.

- Third, they must distribute profits in accordance with the social objectives. That is, these organizations, do not share dividends with their shareholders.

- Fourth, they must have an independent management structure. They plan and implement their own activities. No person or an establishment should interfere in the running of these organizations.

- Fifth, the development of non–profit organizations should be voluntary. In general, the members of the board of trustees are volunteers, yet those who work for the organization do not have to be volunteers.

- Sixth, the non–profit organization have to operate with purposes declared in their charter

# II. EMPIRICAL RESEARCH ON THE CIVIL SOCIETY ORGANIZATIONS OPERATING IN ÜSKÜDAR AND THEIR SOCIAL ROLES

## A. Empirical Research Method

### 1. The Aim of the Research

This research intends to investigate the Turkish CSOs' views regarding the social policy and their relations with the state. It seeks to understand if they are ready to undertake new roles in social policy field.

### 2. The Scope and Coverage of the Research

The research covers the foundations and associations located in Üsküdar, Istanbul. According to the recent data there are currently 4.966 foundations in Turkey (2). Of these foundations, 1,377 are located in Istanbul while only 117 are in Üsküdar *(http://www.vgm.gov.tr).* According to the Directorate of Associations of the Ministry of Interior, 80,706 associations currently exist in Turkey (3). Nearly 20 percent of these (17,061) are in Istanbul. Of these associations 862 operate in Üsküdar *(http://www.dernekler.gov.tr).* Thus, this research will cover 117 foundations and 862 associations (4).

For the purpose of this research, as the number of the foundations was not very high, all foundations were included in the research. A "purposive sampling method" was used for selecting the samples for the associations. Only those associations, whose main activities profoundly related to the social policy issues such as social aid, education, health were determined. From this population 100 associations were randomly selected.

In total, 217 questionnaires were sent to the participants to reply. Only 57 civil society organizations (27 foundations and 30 associations) filled in the questionnaire properly and returned them. Thus the size of the sample, % 5.8 percent of the CSOs operate in Üsküdar, can be accepted as representative.

### 3. The Method of Research

As noted earlier, for collecting data, a questionnaire was used. Initially 217 foundations and associations were contacted via telephone and e–mail, they were asked to fill in the questionnaire, and send back them to the researchers. The result has been evaluated via the SPPS program.

## B. The Evaluation of the Research Results

In the questionnaire, 36 questions were asked to the foundations and associations. The questions were organized in five different categories. The first four categories included the questions on various aspects of the participant organizations. The fifth category questions aims to gather information about the CSOs' approaches to social policy and understanding of the new role in providing social services. In in this article only the final group of the questions will be evaluated (5).

Before evaluating the questionnaire, it is important to note that few empirical researches have, so far, been carried out on the civil society organizations in Turkey. The results of this research have been supported by the research carried out in a larger scale around Turkey *(Çarkoğlu, 2006).* Hence, it is possible to argue that the result of the Üsküdar research may be generalized for Turkey. That is, it could be argued that no matter which part of the country they are located, the traits, understandings, attitudes and activities of the CSOs tend to be very similar in Turkey.

## 1. The View, Evaluation and Expectations of Civil Society Organizations on Certain Issues Concerning Them

### *a. The motivations for founding*

In the section, the motivations behind the establishment and operations of the CSOs in Turkey are examined. According to the answers, although many different reasons are indicated, a vast majority of the participants (73.7 percent) claimed that they were primarily motivated by religious and national values. This is not surprising, since voluntary organizations with non–secular and nationalistic stance constitute a very important segment of the CSOs in most of the developed countries. Their number has been increasing rapidly *(McCleary, Barro, 2008: 513, 519).* 57.9 percent of the participants, on the other hand, indicated that their main motivation was to struggle with socio–economic inequalities. They claimed that the CSOs could be an efficient means to serve for this cause. For 52.6 percent, indicated that their motivations were emanated from a desire to sharing their own human capital, knowledge and experience with the society. For 36.8 percent the motives behind involvement in the civil society were to revive some of the foundations that are historically important. Finally, 20.1 percent of the participants believed that they would pressurize the government over certain political and economic issues by using the power of the civil society organizations.

**Table 1: What were motivations to establish your foundations/associations?**

| | | Number | Percent |
|---|---|---|---|
| a) | Desire to share our own accumulation (capital, knowledge, experience) with the society | 30 | 52,6 |
| b) | Religious and national values, promoting to serve and contribute to the society | 42 | 73,7 |
| c) | Believing that the CSOs are very important means for struggle with the social and economic equalities and shortages in the society | 33 | 57,9 |
| d) | Seeking to pressurize the government politically and economically by this way | 12 | 21,1 |
| e) | Desire to have better statutes in the society | 6 | 10,5 |
| f) | Reviving the foundations which have significant place in the nation's history | 21 | 36,8 |
| g) | Others (please indicate) | 6 | 10,5 |

### *b. Impediments for the effective operations of CSOs*

One of the important questions was about the impediments for the development and effective operations of the CSOs in Turkey. A list of 8 impediments was given and asked to the participants to put them in order in accordance with their significance from their own perspectives. According to the answers, the first 5 impediments and their distribution as follow: 68.4 percent participants claimed that the consciousness about the CSOs is weak in the society, 59 percent believe that people have no interest in their activities, 57.9 percent acclaimed that “lack of equipment and resources, 42.1 percent claimed that there is insufficient supply of qualified personnel, and 36.8 percent believe that prohibitions and bureaucracy are major impediments.

The result demonstrates that people lack enough consciousness regarding the role and importance of CSOs in Turkey. The society does not provide sufficient support for the CSOs. The number of the CSOs and the number of their members clearly shows that the activities of the CSOs do not attract much interest from the society. Some of the reasons for this may include the inadequate modernizations of the society; the insufficient development of the society in economic and social terms, the low level of education, the hostile attitude towards the CSOs by the state.

The third and forth choices in the question were related to the difficulties that these organizations encounter in their operations. The answers reveal that some serious deficiencies prevent the development of CSOs. The CSOs have very severe shortages regarding resources and equipments. The CSOs spent nearly 50 percent of their incomes on wages and the fixed expenditures such as rents, electricity, water and gas. This means that the CSOs have very limited financial resources. Moreover, 62.3 percent participant organizations pay rents for their central and branches offices. 66.7 percent stated that they do not have any property. This means that the CSOs are poor in terms of property in Turkey.

One another reason for the underdevelopment of the CSOs is that most of them do not have adequately qualified personnel to undertake their activities effectively in their field of specialization *(Brinkerhoff, Smith, Teegen, 2007: 59*). This may partly be attributed to their inability to recruit and retain these personnel and partly to the problems causing inefficiencies such as nepotism in their recruitment process and employment practices. It should also be stressed that the shortage of such labour supply in the local labour markets is almost endemic. Thus it can be easily inferred that most of the CSOs are not managed by professionals. Most personnel do not have the adequate skill and expertise in these organizations. What is shocking is that most of the CSOs are not even aware of this problem. Finally the legal and bureaucratic obstacles also constitutes significant problem for the CSOs. The legal and bureaucratic impediments start from the process of establishment and registrations with the state. All sorts of bureaucratic means are employed to hinder or slow down the process of the establishment of a civil society organization. This is encountered in their relations with the state such as tax exemption. Purchasing–selling property, setting international relations and financial auditing are also problems. In the relevant code, a recent amendment has sought to eliminate some of these problems. However many of them persist.

**Table 2: What are the impediments for the development of foundations and associations? Please put in order in line with their importance for your organizations?**

| | Number | Percent |
|---|---|---|
| a) Insufficient resources / equipment | 33 | 57,9 |
| b) Shortage of qualified / specialist personnel | 24 | 42,1 |
| c) Shortage of public interest in the activist of CSOs in the society | 33 | 57,9 |
| d) Insufficient public socio–economic policies | 6 | 10,5 |
| e) Socio–economic crisis experienced in the country | 15 | 26,3 |
| f) Incapability and reluctance of many establishments for collaboration | 15 | 26,3 |
| g) Legal and bureaucratic impediments | 21 | 36,8 |
| h) Weakness of CSOs awareness in the society | 39 | 68,4 |
| i) Others (please indicate) | 0 | 0 |

## *c. The CSOs’ view on some other issues*

The Turkish CSOs are not well–developed compare to those in the developed countries. In Turkey the state, the economic and social structure and even the CSOs themselves may be responsible from this. This was asked in the questionnaire. 68,4 percent participants claim that one of the most important impediment for the CSOs to expand is the paucity of profession managers. Professional management as well as qualified workforce are indispensible necessity for an effective and rational operation of a CSO regardless their size.

Unfortunately, a very severe shortage of qualified personnel currently exists in the CSOs sector in Turkey. Moreover, in contrast to the developed countries, there are no education institutions and certificate programs for the education and training of the CSOs managers in Turkey.

Regarding the state support for the CSOs, two contrasting approaches appear from the analyses of this question. 57.9 percent indicates that the CSOs should not receive support from the state at all. They must be self–sufficient. However, 47.4 percent participants believe that not only material but also moral support from the state is certainly necessary if the CSOs are to flourish. These are two contrasting approaches. One does not expect any aid from the state while the other believes the CSOs cannot flourish that without the state support. It should be point out that both of these approaches are right to some extent. The first approach emphasizing on independence would help the CSOs working for the benefit of publics avoiding the state patronage. Yet, when we look at the relations between state and CSOs in developed countries, it would not be wise to argue that the CSOs should distance themselves from the state. If some increases in the number and activities of the CSOs are desired, the state support should be there to promote the CSOs.

Turkey still has strong and authoritarian state traditions. This has serious implications for the CSOs. The social groups, establishments and any kind of organizing activities, which are not under the state control state, have always been distrusted. Many organizations seeking to promote civil society, even accused of having ulterior motives (such as overthrowing the state or provoking popular uprising) were suppressed, closed down, suffered from constant harassment by the officials and prevented from the expansion at the best in the past until the 1980s. Those, approved by the state, enjoyed recognition and received any kind of supports. In short, the exclusion of the civil society and voluntary organizations has been the dominant state policy towards the CSOs.

However, this policy commenced to change with the unprecedented surge for greater democracy from 1980 onwards in all over the world. Nevertheless, Turkey is still well behind the desired level in terms of the treatment of civil society since the launch of the neo–liberal policies in 1980. The state's distrusts towards the organizations established by religious and ethnic groups largely persist. Yet, it is possible to say that the credibility of the CSOs has recently ameliorated in the eye of the state and society due to the process of Turkey's membership to the EU. The transformations in the legal and social and structure and the mentality have engendered much more convenient and fertile ground for the CSOs to thrive *(Göymen, 2008: 213–215, 225).*

**Table 3: Which choice(s) reflects your view?**

| | | Number | Percent |
|---|---|---|---|
| a) | Voluntariness should be basis of civil society services. Thus, those working in the CSOs should work free. | 24 | 42,1 |
| b) | For adequate development of the CSOs, professional manager should be employed. | 39 | 68,4 |
| c) | The growth of the CSOs is inevitable when a country develop in socio–economic terms. | 27 | 47,4 |
| d) | Insufficient socio–economic conditions do not constitute any obstacle for the CSOs. | 6 | 10,5 |
| e) | Globalization and liberalism are important factor for the development o f the CSOs. | 6 | 10,5 |
| f) | For the development of the CSOs, material and moral support from the state is of outmost importance. | 27 | 47,4 |
| g) | The CSOs should be self–sufficient without the support by the state. | 33 | 57,9 |
| h) | For the CSOs to be thriving, religious and traditional values are very important. | 27 | 47,4 |
| i) | Although the origin of the CSOs is associated with the religious and traditional values, they are not any longer important. | 9 | 15,8 |
| j) | The basis of insufficient interest towards the CSOs in Turkey may be associated with their religious and traditional roots and values. | 3 | 5,3 |
| k) | There are noteworthy differences in the character between the current CSOs and the CSOs of the past in Turkey. | 9 | 15,8 |
| l) | Others (please indicate). | 3 | 5,3 |

Looking at the answers once again, it can be notice that the choices “c and h” have also higher scores. The former seek to set up relations between socio–economic developments of the country. 47.4 percent of the participant agrees with this view. 47.4 percent of the participants also believe that for the success of the CSOs religious and traditional values are very important.

## 2. The Aspects of the Support to the CSOs by the Society and State

### *a. The aspects of the supports to the CSOs by the society*

It may be argued that the public awareness, regarding the role and activities of the CSOs, is not sufficiently developed in Turkey. This point is also highlighted in some other studies. Looking how people give their charity and social aid to those in needs shows that many people prefer giving their charity and social aids directly to those who are in need rather than via a CSOs. Giving such aids by the CSOs has been proved certainly more efficient and effective. Yet, this view is not shared by most of the society. A recent empirical study investigating the attitude of the society towards social aids for those, who are, in need provides ample support for this argument. According this study, when asked how would like to give your charity to poors, the 86.9 percent of the participants preferred doing so personally. Only 11.5 percent of the participants claimed that they would prefer reaching those people via CSOs *(Çarkoğlu, 2006: 85, 88, 90).* The may be considered as the expression of societal disinterest in the CSOs in Turkey.

When asked if the effectiveness of the CSOs is currently increasing, 66.7 percent of the participants believe that their effectiveness is increasing while the 33.3 percent believe that it is partly increasing. No participant believes that the effectiveness of the CSOs is not increasing.

**Table 4: Do you think the effectiveness of the CSOs is increasing currently?**

| | Number | Percent | Valid Percent |
|---|---|---|---|
| Yes | 36 | 63,2 | 66,7 |
| Partly | 18 | 31,6 | 33,3 |
| No | 0 | 0 | 0 |
| **Total** | 54 | 94,7 | 100,0 |
| **No Reply** | 3 | 5,3 | |

Nevertheless this view contradicts the answers given to the next 3 questions. Despite optimism in this question, these answers show that for the increasing effectiveness and importance of the CSOs, the required environment has not developed. This is because neither the state nor the society has provided the necessary support.

These questions clearly demonstrate the reality in Turkey. In Turkey, the support given to the CSOs has always been much lower than the developed nations. Although the role and significance of the CSOs are increasing worldwide, they are deprived of the popular support they deserve. In the question 5 seeking to measure if the required support given to the CSOs, only the 10.5 percent of the participants organization said “yes”. The 63.2 percent of the participants believe that they receive only the part of the support that they required. The 26.3 percent of the participants said that they do not get any support at all.

**Table 5: Do you think that the civil society organizations are adequately support by the society?**

| | Number | Percent |
|---|---|---|
| Yes | 6 | 10,5 |
| Partly | 36 | 63,2 |
| No | 15 | 26,3 |
| **Total** | 57 | 100,0 |

The CSOs were asked why people in this country are not very much interested in the CSOs? They attributed this disinterest to a number of factors. One of them is the heavy dependence on the state. The persistence of the clientelist and paternalist attitude of the state may be the reason for this. This is because most people expect the state step in and provide solution whenever they have problems rather than finding their own solution by organizing.

In the developed countries, when people are in an abject poverty, state was the first to apply. Although the state still performs this important role function, its role as the sole provider of social aid and services has undergone transformation since the 1980s. In the developed countries, the State–CSOs relations have reached unprecedented level. The state used to produce many social services and aids. Yet it now prefers providing them via the CSOs because this way is more effective and cheaper. Thus, the aid still belongs to the state. Yet who provides this aid is a significant issue. Producing the social aids directly was more suitable for the conditions prevailing before the 1980s. Yet providing tem via the CSOs seems to be the most preferred model of today *(Özdemir, 2004a: 145–146).*

The statement "f" indicates to a fact and it is also confirmed by the participants. The ineffectiveness of the activities of the CSOs prevents them promoting themselves adequately and finding the required support in the form of charity and aids. This vicious circle continues. The problem of recognition appears in the choice "a". Those CSOs which cannot promote itself sufficiently are regarded as useless organizations. The choice "b" points out the shortage of trust. In the public opinion, the CSOs pursue their own interests rather than that of society and upheld the interests of the managers.

**Table 6: Why do not people have sufficient interests in the CSOs in Turkey?**
**(You can thick more than one choice)**

| | | Number | Percent |
|---|---|---|---|
| a) | It is believed that these organizations are useless. | 21 | 36,8 |
| b) | They do uphold the interest of the managers rather than that of the society | 21 | 36,8 |
| c) | It is believed that some of these organizations conduct international undercover operations with illicit purposes and they are untrustworthy. | 9 | 15,8 |
| d) | The existence of the CSOs disregarding the region and traditions are disturbing. | 6 | 10,5 |
| e) | The state's distrust towards the CSOs influences the society. | 12 | 21,1 |
| f) | The CSOs cannot promote themselves sufficiently to the society. | 24 | 42,1 |
| g) | Rather than solving their problems by organizing themselves the attitude of expecting the state to step in to provide solutions is still very strong in Turkey. | 27 | 47,4 |
| h) | The tradition of foundations has been deliberately undermined in this country, thus leaving the society without a strong basis. | 18 | 31,6 |
| i) | Turkey's inability to generate the same welfare, social and cultural level with the developed nations prevents the strengthening of the CSOs. | 18 | 31,6 |
| j) | Others (please indicate) | 3 | 5,3 |

## *b. The aspects of the support for the CSOs by the state*

In the literature on the CSOs, it very often emphases that in the society, where the CSOs are more developed, the State–CSOs relations are of paramount significance. In these countries, the state does not seek to prevent the CSOs; on the contrary it not only promotes but also prepares the environment for them to thrive. However it is claimed that a negative political culture constitutes a major impediment for the development of the CSOs. Although Turkey has been currently undergoing a great transformation, its political culture has been historically based on the upholding and sanctifies the state over everything. Under such political culture, the development of the civil society and the CSOs are not welcomed and are distrusted by the state as well as the society. In Turkey, few CSOs, have managed to gain the confidence of the state *(Göymen, 2008: 226).*

Unsurprisingly the answers given to the question about the state support for the CSOs also confirms above view. It is also alarming for the future of the CSOs. None of the participant CSOs that answered the question, clearly expressed that they have received support either form the central or from the local government. As can be seen from the table 7 that the 52. 9 percent of the participant CSOs believe that the state do not support the CSOs at all. Although the 47.1 percent believe that the state support is not sufficient, they have not yet received any support as well.

For those who say that they have not yet received any state support, this mains that that the public authorities do not provide material support for the CSOs, do not buy any services from them, do not provide some services via CSOs, do not allow the participation of the CSOs for policy making and even do not ask their opinion from time to time and do not care them at all.

**Table 7: Do you think the Civil Society Organizations receive enough support from the central and local governments?**

| | Number | Percent | Valid Percent |
|---|---|---|---|
| Yes | 0 | 0 | 0 |
| Partly | 24 | 42,1 | 47,1 |
| No | 27 | 47,4 | 52,9 |
| **Total** | 51 | 89,5 | 100,0 |
| **No Reply** | 6 | 10,5 | |

In a larger survey carried out by Çarkoğlu *(2006: 155–160)*, those CSOs having relations with the state appear slightly more 55,8 percent. The state apparatus where the highest level of the CSOs relations can be found is the municipalities. This is followed by the district national education directorates, governors, muftiship... etc.

# 3. CSOs' Approach to Social Policy

The questions below are of paramount significance regarding the very existence and future of the CSOs. In the world, after the globalizations, a change has taken place among the social policy actors regarding the provision of the social aid and social welfare services.

In developed world, the state, sought to provide social policy for their citizen on its own from the first quarter of the 20th century onwards. Nevertheless, a new era for the provision of social policy was launched in the developed world in 1980. The CSOs was re–discovered and given a very significant role in the provision of social policy. A new division of labour was formed among the central and local authorities and CSOs for the provision of various social services. For this very reason the state has established collaborative relations with voluntary organizations. Now the state prefers buying the services from these organizations rather than producing them.

The main reason behind this preference is that with the more flexible and decentralized structures the CSOs are capable of providing cheaper and more effective services. After the 1970's the ascendant neo–liberal currents accused the state of being unproductive and ineffective. They forced it to withdraw from social policy along with many other areas. This development contributed the development of the CSOs both in qualitative and quantitative terms *(Özdemir, 2004b: 109).*

In developed countries, the process of the transformations which give rise to transferring, to a large extent the state responsibility concerning social policy to the CSOs. Not only have not been experienced yet in Turkey, but also the CSOs are neither aware nor enthusiastic towards such a change that will alter their destiny. Unfortunately two questions below demonstrate that the CSOs have accepted their destiny, are extremely reactant to do something to alter their future. This is very much noticeable from the questionnaire. As can be seen from the table 8 that 33.3 percent of the participant CSOs are against the transfer of social responsibility from the state to any other organizations including the CSOs. Only the 11 percent of the CSOs support such initiative and express willingness to take some responsibility. The rest, (55,6 percent) avoid to replying this questions and do not believe that such transfer can be possible. In some developed countries such as the USA, the majority of the CSOs support the transfer of the social aids and social services to voluntary organizations. In the countries where this transfer has taken place, the growth of the CSOs has been observed.

It is, therefore, a must for the Turkish CSOs to welcome this development and undertake increasingly responsibility for the provision of the social policy. If the CSOs have still state–centered views and are unaware what is going on in the world, nothing can be done to change their destiny. It is probably that the CSOs are in the opinion that they may not be able to overcome the provision of social policy and thus lack self confidence.

**Table 8: Do you think the CSOs should take over the state's responsibility for social policy?**

| | Number | Percent | Valid Percent |
|---|---|---|---|
| Yes | 6 | 10,5 | 11,1 |
| No | 18 | 31,6 | 33,3 |
| Possible | 30 | 52,6 | 55,6 |
| **Total** | 54 | 94,7 | 100,0 |
| **No Reply** | 3 | 5,3 | |

The next question is about the role that the CSOs considers for themselves in Turkey is also important. The answer reveals that the Turkish CSOs lack self–confidence. The participants claim that they would not accept any responsibilities stated below with one exception. 57.9 percent claims that the social responsibly for providing monetary and material social aids to poor will be properly performed by the CSOs along with the state. However, most of the participants acclaim that the state would carry out the other six responsibilities indicated in the table below, much better than the CSOs. They believe that it is more useful if the state continues to provide these services.

In other words, the Turkish CSOs supported the idea that state should maintain to provide the protective social services, such as health services, education and training for children, elderly and disables. This means that they seemed to be as if they are unaware about the international advancements regarding the CSOs in the world and mentally not ready for undertaking such jobs. However, in the advanced countries, the role of the state in the provision of these services is diminishing. What is more in some countries such as the USA, most of the health establishments and universities, service establishment for family and children, local development organizations are run by the CSOs. The share of the CSOs in the provision of the social policy currently is more than 40 percent and is proliferating *(Salamon, 2003: 3–61).*

An interesting point as to the Tables 9 and 10, nearly half of the representatives of the voluntary organizations which agree with the transfer of social responsibilities to the CSOs, claimed that it is better if education and health services provided by the state. This was noticed when a comparative analysis was undertaken.

**Table 9: Which is better for those who demand the social welfare services and for the country: the state should maintain to provide social welfare services or the state should provide them via the CSOs.**

| | State | | CSOs | |
|---|---|---|---|---|
| | No | % | No | % |
| Monetary and material social aids for poors / those in need | 24 | 42,1 | 33 | 57,9 |
| Protective social services for children | 39 | 68,4 | 18 | 31,6 |
| Social services for elderly | 39 | 68,4 | 18 | 31,6 |
| Social services for women | 36 | 63,2 | 21 | 36,8 |
| Social services for disables | 39 | 68,4 | 18 | 31,6 |
| Education and training services | 36 | 63,2 | 21 | 36,8 |
| Health services | 39 | 68,4 | 18 | 31,6 |

The view that the state provides social aids and social services better than anyone, dominate not only the CSOs but also the entire society in Turkey. The survey carried out by Çarkoğlu also confirms this view. According to his results, 38.2 percent of participants believe that social aid is primarily the responsibility of the state in Turkey. 30.9 percent believe that it is also the individual responsibility of wealthy people. Only 5,4 percent indicate that the CSOs should have some responsibility in this respect. Hence, it is possible to argue that in the mind of individuals, there is very small role for the CSOs for providing social services. This means that when people give charity, only few of them take the CSOs into consideration.

**Table 10: Do you think who should help the poors?**

| | Percent |
|---|---|
| State | 38,2 |
| Wealthy people | 30,9 |
| Everybody | 20,9 |
| CSOs | 5,4 |
| Religious people | 4,2 |
| Municipalities | 0,2 |
| Others | 0,1 |

See: *(Çarkoğlu, 2006: 85)*

# CONCLUSION

The concept and issue of the civil society organizations, philanthropy, non–profit organizations, and social capital has been disregarded by social scientist and the public officials for a long–time. As social policy and welfare state developed, discussion on markets, state and social policy dominated the agenda in the post war epoch. The CSOs was considered as an insignificant issue. Nevertheless, following the ascendancy of the neo–liberal economic policies, this approach changed in the late 1970s. As the state has withdrawn from the economic and social realms, the CSOs were re–discovered as alternative to the public provision of social services in many developed countries. Thus, the CSOs have, recently, become one of the most important economic and social actors in the developed countries. They are seen as a "middle way" between the state and market and are called as "third sector". In these countries, the state seeks to generate an environment conductive for the growth of the CSOs. The high quality relations between states and the CSOs constitute the basis the phenomenal revival of the CSOs

Unfortunately this is not the case in Turkey for the time being. The CSOs have neither mentally nor economically developed to undertake the responsibility for the provision of the social welfare state. There are number of reasons for this insufficient development of the CSOs. One of them is the existence of poor relations between the state and CSOs. In contrast to the developed countries, the state is reluctant to promote the civil society. This may be related to the authoritarian character of the state. The state has always distrusted the civil society and sought to keep any civil organizing attempt, which would challenge the state authority, under stick control. Thus, the growth and expansion of the civil society may be deliberately prevented. The state is reluctant to hand over some of its authority and responsibility to the civil society. This means that CSOs have not obtained sufficient support from the state to flourish. This also means that the state have no intention to purchase services from the CSOs and does not involve or consult the CSOs in the formulation of social policies.

Thus, it can be legitimately concluded that the state may partially be hold responsible for this apparent insufficient development of the CSOs in Turkey. Our findings provide ample support to this argument. Nevertheless, the process of Turley's integration to the EU and economic and social development, it may argued that the CSOs will discover their potential as well as get better recognition from the state and society.

One another reason for the dismay of the Turkish CSOs may be themselves. Reviewing the literature and the fieldwork results demonstrate that most of the CSOs are even unable to perform their own duties determined by their charters. Nevertheless, those with sufficient financial resources have not changed their mentality at all. They are still disinclined to have any major role in the society. In many developed countries, the responsibility of the state for the provision of social and welfare services is shifting to the civil society organizations. Most of the Turkish CSOs tend to believe that providing social services is the responsibility of the state and reluctant to undertake any responsibility in this regard. Consequently it is possible to argue that the most striking result of this research is that the most of Turkish CSOs turn a blind eye to the changing international economic and political environment of the CSOs in the world.

## ENDNOTES

(1) Liberalism calls for the increasing role of voluntary organizations and the private sector in the in the provision of social welfare services. In addition, family and other spontaneous aids can be used as a means in the provisions of the services.

(2) 28 percent of the country's foundations are located in İstanbul. The foundation situated in Üsküdar constitutes 8, 5 percent of the total foundations in Istanbul. This scores the highest rate among the 32 districts in Istanbul.

(3) 21 percent of the country's association are located in İstanbul. Of these 5.1 percent are in Üsküdar. Considering the number of the districts in Istanbul this is also a very high rate. Looking at the number of foundations and associations it is possible to say that Üsküdar has more civil society organizations than 60 cities in Turkey.

(4) The distribution of the 862 associations as follows: 212 social aids, 182 countrymen, 123 sports, 91 Mosque, 59 educations, 11 businessmen, 9 health associations. The rest 175 are various forms of associations.

(5) The same questionnaire has been widely evaluated in a different study. See: *(Özdemir, et al, 2009: 151–234).*

## REFERENCES


Akdemir, Ali, A. Kazım Kirtiş, Mehmet Marangoz and Ali Şahin Örnek (eds.) (2008), ***V. International NGOs Conference Proceedings Book,*** Çanakkale: Çanakkale Onsekiz Mart University Publ.

Anheier, Helmut K. and Regina A. List (2005), "NGOs (Non–Governmental Organizations", ***A Dictionary of Civil Society, Philanthropy and the Non–Profit Sector,*** New York: Routledge Publ.

Ankara Chamber of Commerce (ACOC) (2004), ***Civil Society Folder While Entering the EU*** (***AB Kapısında Sivil Toplum Dosyası),*** Ankara: ACOC Publ., 2004, http://195.155.145.1/turkce0index10.html, November 02, 2004.

Aydın, Davut, Murat Çizakça, Ali Çarkoğlu and Fatoş Gökçen (eds.) (2006), ***Philanthropy in Turkey: Citizens, Foundations and Social Justice (Türkiye'de Hayırseverlik: Vatandaşlar, Vakıflar ve Sosyal Adalet),*** İstanbul: TÜSEV Publ.

Brinkerhoff, Jennifer M., Stephen C. Smith and Hildy Teegen (2007), "Beyond the 'Non': The Strategic Space for NGOs in Development", ***NGOs and the Millennium Development Goals: Citizen Action to Reduce Poverty,*** (eds: Jennifer M. Brinkerhoff, Stephen C. Smith and Hildy Teegen), New York: Palgrave Macmillan Publ., pp. 53–80.

Burlingame, Dwight F. (ed.) (2004), ***Philanthropy in America: A Comprehensive Historical Encyclopedia,*** Vol.: 1, California: ABC–CLIO Publ.

Çarkoğlu, Ali (2006), "Individual Charity, and Tendency in Foundation Implementation" ("Türkiye'de Bireysel Bağışlar ve Vakıf Uygulamalarında Eğilimler"), ***Philanthropy in Turkey: Citizens, Foundations and Social Justice (Türkiye'de Hayırseverlik: Vatandaşlar, Vakıflar ve Sosyal Adalet),*** (eds.: Davut Aydın, Murat Çizakça, Ali Çarkoğlu and Fatoş Gökçen), İstanbul: TÜSEV Publ.

Copley, Paul A. (2004), "Effects of Nonprofit Organization Wealth and Efficiency on Private Donations to Large Nonprofit Organizations", ***Research in Governmental and Nonprofit Accounting,*** Vol.: 11, pp. 71–91.

Easterly, Lisa, and Paul Miesing (2008), "NGOs, Social Venturing, and Community Citizenship Behavior", ***Business & Society,*** April 2008, pp. 1–27, http://www.albany.edu/~pm157/research/NGOs,%20 Social%20Venturing,%20and%20Community%20Citizenship%20Behavior.pdf, February 18, 2009.

Fremont–Smith, Marion R. (2004), "The Nonprofit Sector in the Twenty–First Century", ***Governing Nonprofit Organizations: Federal and State Law and Regulation,*** Massachusetts: Harvard University Press.

Göymen, Korel (2008), "The Evolving State–Third Sector Relations in Turkey: From Subservience to Partner Status?", ***The Third Sector in Europe: Prospects and Challenges,*** (ed.: Stephen P. Osborne), New York: Routledge Publ., pp. 212–229.

Henriksen, Lars Skov, Thomas P. Boje, Bjarne Ibsen and Inger Koch–Nielsen (2008), "Welfare Architecture and Voluntarism: Or Why 'Changing the Welfare Mix' Means Different Things in Different Contexts", ***The Third Sector in Europe: Prospects and Challenges,*** (ed.: Stephen P. Osborne), New York, Routledge Publ., pp. 69–86.

Jenei, György, and Eva Kuti (2008), "The Third Sector and Civil Society", ***The Third Sector in Europe: Prospects and Challenges,*** (ed. by: Stephen P. Osborne), New York: Routledge Publ., pp. 9–25.

Keyman, E. Fuat (2006), ***The Advanture of Civil Society in Turkey: A Oasis in Impossibility (Türkiye'de Sivil Toplumun Serüveni: İmkansızlıklar İçinde Bir Vaha),*** Ankara: STGM Publ.

Kozak, İbrahim Erol (1994), ***Foundations as a Social Policy Institution (Bir Sosyal Siyaset Müessesesi Olarak Vakıf),*** Adapazarı: Sakarya University Publ.

Luksetich, William (2008), "Government Funding and Nonprofit Organizations", ***Nonprofit and Voluntary Sector Quarterly,*** Vol.: 37, No: 3, September 2008, pp. 434–442.

McCleary, Rachel M. and Robert J. Barro (2008), "Private Voluntary Organizations Engaged in International Assistance, 1934–2004", ***Nonprofit and Voluntary Sector Quarterly,*** Vol.: 37, No: 3, September 2008, pp. 512–536.

Moore, Louella (2001), "Legitimation Issues in the State–Nonprofit Relations", ***Nonprofit and Voluntary Sector Quarterly,*** Vol.: 30, No: 4, December 2001, pp. 707–719.

Özbek, Nadir (2002), "From Ottoman Empire to Day Social State in Turkey" ("Osmanlı'dan Günümüze Türkiye'de Sosyal Devlet"), ***Toplum ve Bilim,*** Issue: 92, Spring 2002, ss. 7–33.

Özdemir, Süleyman (2007), ***Globalization and Welfare State (Küreselleşme Sürecinde Refah Devleti),*** Second Edition, Istanbul: Istanbul Chamber of Commerce (ICOC) Publ.

Özdemir, Süleyman (2009), "A Dissertation on the Growing Importance of the NGOs and Some NGOs Operating in Uskudar District, Istanbul" ("Sivil Toplum Kuruluşları (STK)'nın Artan Önemi ve Üsküdür'da Faaliyet Gösteren Bazı STK'lar Üzerine Bir Araştırma"), ***Journal of Social Policy Conferences,*** (Co–writer with H. Basel and H. Senocak), Vol.: 56, Istanbul: Istanbul Univ. Faculty of Economics Publ., 2009, pp. 151–234.

Özdemir, Süleyman (2004a), "Non–Profit Organizations and Their Increasing Roles in Social Welfare Provision" ("Kar Gütmeyen Kuruluşlar (KGK) ve Sosyal Refahın Sağlanmasında Artan Rolü"), ***Journal of Social Policy Conferences,*** Vol.: 48, Istanbul: Istanbul Univ., Faculty of Economics Publ., pp. 129–161.

Özdemir, Süleyman (2004b), "A New Approach on Social Welfare Provision: 'Welfare Mix' and Institutions of Welfare" ("Sosyal Refah'ın Sağlanmasında Yeni Bir Anlayış: 'Refah Karması've Refah Sağlayıcı Kurumlar"), ***Journal of Social Policy Conferences,*** Vol.: 48, Istanbul: Istanbul Univ., Faculty of Economics Publ., pp. 98–127.

Payton, Robert L. and Nichael P. Moody (2008), ***Understanding Philanthropy–Its Meaning and Mission,*** Bloomington: Indiana University Press.

Pierson, Christopher (2001), ***Modern State,*** (Trans.: Dilek Hattatoğlu), İstanbul: Çiviyazıları Publ.

Pinch, Steven (1997), ***Worlds of Welfare: Understanding the Changing Geographies of Social Welfare Provision,*** London: Routledge Press.

Salamon, Lester M. (2006), ***America's Nonprofit Sector: A Primer,*** New York: The Foundation Center.

Salamon, Lester M. (2003), "The Resilient Sector: The State of Nonprofit America", ***The State of Nonprofit America,*** (ed.: Lester M. Salamon), Washington, D.C.: Brookings Institution Press, pp. 3–61.

Salamon, Lester M. (1999), ***America's Nonprofit Sector: A Primer,*** New York: The Foundation Center.

Smith, David Horton, Robert A. Stebbins and Michael A. Dover (2006), ***A Dectionary of Nonprofit Terms & Concepts,*** Indiana: Indiana University Press.

Şahin, Levent and Mustafa Öztürk (2008), "Globalization and the Civil Society Organizations: The Situation in Turkey" ("Küreselleşme Sürecinde Sivil Toplum Kuruluşları ve Türkiye'deki Durumu"), ***Journal of Social Policy Conferences,*** Vol.: 54, Istanbul: Istanbul Univ., Faculty of Economics Publ., pp. 3–29.

Şahin, Mehmet (2007), ***Public Economy and Civil Society Organizations (Kamu Ekonomisi ve Sivil Toplum Kuruluşları),*** Ankara: Seçkin Publ.

Şenkal, Abdülkadir (2003), "Globalization, Transformation of Social Policy, and Civil Society Organizations", ("Küreselleşme, Sosyal Politikanın Dönüşümü ve Sivil Toplum Örgütleri"), ***Journal of Social Policy Conferences,*** Vol.: 45, Istanbul: Istanbul Univ., Faculty of Economics Publ., pp. 97–123.

TurkSat (Turkish Statistical Institute) (2009), ***Household Labour Force Statistics: Results of Nov.–Dec. 2008, and Jan. 2009 Survey (Hanehalkı İşgücü Araştırması 2008 Aralık Dönemi Sonuçları, Kasım, Aralık 2008, Ocak 2009),*** http://www.tuik.gov.tr/PreHaberBultenleri.do?id=4014.

Ullman, Claire F. (1998), ***The Welfare State's Other Crisis: Explaining the New Partnership Between Nonprofit Organizations and the State in France,*** Bloomington: Indiana University Press.

Uslu, İbrahim (1999), "Non–Profit Organizations as a Means of Social Policy", ("Bir Sosyal Siyaset Vasıtası Olarak Kâr Gütmeyen Kuruluşlar: ABD Örneği"), (Unpublished Ph.D. Thesis), İstanbul: İstanbul Üniversity, Social Sciences Institute.

Young, Dennis R. (2000), "Alternative Models of Government–Nonprofit Sector Relations: Theoretical and International Perspectives", ***Nonprofit and Voluntary Sector Quarterly,*** Vol.: 29, No: 1, March 2000, pp. 149–172.

http: //www.dernekler.gov.tr

http://www.vgm.gov.tr

# LINKING PERFORMANCE TO STRATEGY IN THE PUBLIC SECTOR

**Bilge Terken Ataoğlu**
**TÜBİTAK TÜSSİDE**
**(Turkish Institute for Industrial Management)**

## ABSTRACT

*Over the past two decades, public sector performance has become an important matter as countries have faced with fiscal stress, spending constraints against citizens demanding for better public services but unwilling to pay higher taxes, increasing public pressure for accountability and transparency. However, improving performance for the public sector is a challenge, because there is a blurred understanding of strategy, vision, performance concepts in some countries. This paper examines the relationship between performance and strategy in the public sector and discusses one of the models for linking performance to strategy, which is called the Balanced Scorecard (BSC). Firstly, the meaning of performance and its management in the public sector has been reviewed, then the relationship with the strategy concept introducing the BSC model discussed. The paper concludes with a few implications for state owned enterprises supported with consultancy experiences.*

***Keywords:*** *Performance, Strategy, the Balanced Scorecard, Public sector, State Owned Enterprises*

## INTRODUCTION

From the 1970s, there has been significant pressure on public sector organizations in the advanced economies arising from volatile economic conditions and pressures for government spending cutting. Due to the pressures, the public sector organizations have taken “performance” as their priorities while meeting demands from citizens. Because of resource constraints, they have to behave strategically to become responsive for what matters to public. This has driven the change in the public sector, economic and efficient while using resources, responsive while meeting public needs, citizen-oriented organizations have emerged as the replacement of traditional administrative structures.

In a traditional administrative structure, performance is driven by complying with the rules and procedures. This structure type has responded for a long time when the demands are stereotype, the tasks are standardized. However, in a modern society, people demand more customized services with high quality in payment for lower taxes. The pressure for getting better results from existing funds has brought the change in performance issues in the public sector. Within this context, accountability, value creation without abusing public resources and transparency are the basis for effective performance based management. This transformation has also caused significant improvements in the decision making processes within public sector organizations.

While making decisions under some constraints, public sector organizations should have a good roadmap to create public value. A well-prepared map consists of well-defined routes, we can call these as strategies, and distance metrics between the current place and the future place to be after some time. In other words, it is matter that an organization manages to close the gap between what has been planned and what is achieved. The focus of this paper is the model translating strategies into performance and its use in the public sector. The Balanced Scorecard is one of the models assisting organizations in overcoming two key issues: implementing strategies and measuring organizational performance effectively. The scorecard allows an organization to translate its vision and strategies through the measures chosen. However, using scorecard model in public sector organizations is difficult because there are a blurred sense of vision and strategy, a budget-based economy and employees who are motivated more by survival than by achievement. Nevertheless, among these organizations, state-owned enterprises (SOEs), also referred to as government corporations or public economic enterprises, can be the organizations in which the scorecard model is implemented.

## Literature review: Performance

"Performance" is a term that encompasses many different concepts. The word "perform" means to do, to accomplish. The act of performing means to carry out a goal or responsibility. Drucker (1973;455) points out that performance is the pure essence of management, independent of time, place, or type of business. Drawing upon the work of Kushner and Poole (1996;171-80), the performance of an organization may be modeled along four components: *resource acquisitions, efficiency, goal attainment and client satisfaction.* Performance is a relative concept and hence it is often measured against some baseline or standard (what has been accomplished in the past, a comparable process or organization or a target). It can be concluded that performance is not a static measure, it requires ongoing feedback from situations and results.

Performance measurement is a process to reduce the amount of uncertainty about the value of a quantity. Metrics are the various parameters or ways of looking at a process that is to be measured. Performance management includes both the measurement of performance and the usage by management for decision making and by external stakeholders for accountability purposes. The term "performance management" was first used in the 1970s, but it did not become a recognized process until the latter half of the 1980s (Armstrong & Baron, 1998).

Fowler (1990) defines performance management as:

> "...the organization of work to achieve the best possible results. From this simple viewpoint, performance management is not a system or technique, it is the totality of the day-to-day activities of all managers".

Storey and Sisson (1993) define performance management as:

> "...an interlocking set of policies and practices which have as their focus the enhanced achievement of organizational objectives through a concentration on individual performance."

Fletcher (1992) provides a more organizational definition of performance management:

> " ..an approach to creating a shared vision of the purpose and aims of the organization, helping each individual employee understand and recognize their part in contributing to them, and in so doing manage and enhance the performance of both individuals and the organization."

A well-defined performance management system is a holistic design focusing on management and improvement, accountability and control, budgetary savings. In this context, a comprehensive performance management process includes the following steps:

- Strategic planning (planning for results)
    - Vision, goals and objectives
- Activity planning
- Developing meaningful and relevant performance measures
- Budgeting for results
- Managing work processes, collecting data and using the data to manage
- Evaluating and responding to results
- Reporting results
- Monitoring

Also, the following ten traits characterize the most effective performance management systems:

1. *Outcome focused*
   Outcome goals focus attention on the future state of organization and its programs/activities, energize employees, and make it easier to enlist external cooperation
2. *Few, simple and resonant at the top*
   Concentrating on a few goals and building a performance measurement and management system is better, everything cannot be priority
3. *Challenging, but realistic*
   Setting stretch targets and framing goals that are ambitious but not overwhelming is preferred.
4. *Cascading down and folding back up*
    a. Designating authority and accountability for leading the effort to accomplish a goal
    b. Making sure the people in the organization understand how they are expected to contribute to each organizational goal
5. *Broadly used*

Performance measurement becomes powerful when actively and regularly used at all levels of the organization, from the very top to the front line.

6. *Visible*
   Performance information has little value if it is not readily available
7. *Interactive and informational*
   Helping people/organization embrace and understand benefits of analyzing past performance information to develop more effective future strategies
8. *Frequent and fresh*
   Up-to-date, detailed performance data and information helps employees to detect and correct problems.
9. *Segmentable*
   The ability to segment information helps employees to interpret the results, draw conclusions and improve performance.
10. *Fact based*
    Measurement accuracy is an essential and integral component of an effective performance management system.

The purpose of measuring performance is not only to know how a business is performing but also to enable it to perform better. The ultimate aim of implementing a performance management system is to improve the performance of an organization so that it can better serve its customers, employees, stakeholders. Performance management is also important because of the following benefits:

- Supports strategic plan of the organization
- Tracks progress towards goals of organization using metrics
- Improves accountability
- Facilitates corrective actions to address performance gaps

Nevertheless, effective performance management is crucially supported by organizational culture. (Nohria *et al* 2003). According to the survey on the web page, named *www.bettermanagement.com,* points out that there are some cultural obstacles against performance management in the public sector. The following results figures out these obstacles:

- Cultural resistance to performance measures (49%)
- Departments do not share information, lack of collaboration (42%)
- Insufficient communication of strategy (27%)
- Poorly defined strategy (26%)
- Little accountability (24%)
- Lack of corporate alignment (24%)
- Ineffective strategy execution (24%)
- No executive champion (22%)
- Lack of buy-in from bottom up (17%)

## What does performance mean for public sector?

As stated before, public sector organizations have to improve service quality while progressively lowering their spending. At the same time, they are expected to become more accountable and responsive to public's needs. Achieving these goals involves a transformation in management practices, internal and external organizational processes and culture. Therefore, it is needed to measure and manage performance of public sector.

For public sector organizations, performance means the yield or results of activities carried out in relation to the purposes being pursued. Its objective is to strengthen the degree to which governments achieve their purposes while spending to budgeted amounts. In the context of success for public sector organizations, it should be measured by how effectively and efficiently they meet the needs of people.

The performance management process is a comprehensive approach for aiding public policy and administrative organizations to focus on their vision, goals, and objectives. It establishes the accomplishment of those goals and objectives as the main effort for the organization and provides a systematic method for carrying out that effort. It requires the (1) establishment of performance measures, (2) use, and (3) reporting of those measures; so that management, elected officials and the public can assess the degree of success the organization has in accomplishing its vision, goals, and objectives. According to OECD (1995), performance management covers corporate management, performance information, evaluation, performance monitoring, assessment and performance reporting.

Performance measures in government are basic to good management and accountability. Public managers have eight primary purposes for performance measurement: to evaluate, control, budget, motivate, promote, celebrate, learn, and improve (Behn, 2003, 588).In spite of its value for the public sector, performance is difficult to measure. Another problem associated with government performance is the lack of meaningful performance measures, or the presence of multiple measures.

All of the reliable, relevant, and timely information is of little use to public managers if they don't know what to do with it. Hatry (1999) suggests that public managers use performance information for the following tasks:

- Responding to demands for accountability from elected officials and the public
- Formulating and justifying budget requests
- Making internal resource allocation decisions
- Examining performance problems or achievements and possible corrections
- Motivating personnel to continue making program improvements
- Formulating and monitoring contracts and grantees
- Evaluating programs
- Supporting strategic planning
- Communicating more effectively with the public to build public trust
- Providing better services more efficiently

According to the results of the Performance Improvement Web Survey respondents who are employees from public sector worldwide focused on the following benefits from performance management in their organizations in general:

- Resource alignment and optimization
- Strategic and cross departmental alignment, collaboration and accountability
- Budgeting and planning process aligned with strategy

As improving public sector performance becomes more important to citizens, in electoral terms it becomes increasingly necessary for governments to demonstrate that they are achieving these improvements. Compared to private sector in which profitability, market share and customer satisfaction are important, public sector, in which there is an obligation to serve the general good even if the operations are redundant, is driven by political issues.

The budget is the traditional management tool used to guide the activities of government. Nevertheless, budget is the wrong way to manage in the public sector, because the indicator of good performance is to spend this year's budget and to get a larger budget next year. Also, to focus on the size of budget instead of the outcomes got from budget is another performance issue. As mentioned above, the success for public sector is how effective and efficient they are while meeting needs. In short, performance management is a powerful means by which public sector organizations can advance their visions and strengthen democracy in general.

The provision of performance information is not an end in itself; rather, its overall objective is to support better decision making by politicians and public servants leading to improved performance and accountability, and ultimately, enhanced outcomes for society. Effective performance management systems provide public sector organizations with means for planning and implementing strategies; for influencing organizational behavior and to focus, compel, monitor and reward people, for communicating with stakeholders both internally and externally, and for adopting and developing the principles of learning organization.

## The Link Between Strategy

Strategy tells us how an organization intends to accomplish its future state. Michael Porter makes the point that strategy includes not only what is important to do; it also includes what not to do and what not to focus on. Strategy can be interpreted more broadly as a means to improve public services, whether these are provided by one agency or whole networks of organizations (Boyne, 2003). As for strategic planning, it can be defined as a path that takes an organization from its current situation to its desired situation by planning for results. Strategic planning offers the opportunity for public organizations to be truly forward looking and innovative. According to Bryson (2004), strategic planning is a disciplined effort to produce fundamental decisions and actions that shape and guide what an organization is, what it does, and why it does it, with a focus on the future.

The use of performance data is a best way to inform strategic plans, it transforms a strategic plan from a document to one that successfully guides an organization into the future. It is figured out that strategic planning helps organizations with better performance results after a systematic, structured and data based process. Also, when strategic planning is developed through a participatory process, the staff and the other stakeholders focus on the performance to make a difference for the organization.

Getting organizations to manage for results is the focus of performance concept. A performance management system enables an organization to plan, measure and control its performance according to a pre-defined strategy. In other words, performance management is a fundamental process required to track the achievement of strategies, it provides feedback on how well the strategy is working.

While choosing an appropriate performance management tool to put strategies into actions, it is important to evaluate the pros and cons. There are some tools to manage performance: Balanced Scorecard, The European Federation for Quality Management, Malcolm Baldridge National Quality Award, Performance Prism, Excellence Model, Performance Pyramid and Economic Value Added.

According to Bain & Company's survey completed in 2007, the Balanced Scorecard is one of the most popular management tools used by global executives. Also, a citation analysis conducted by Marr and Schiuma (2003) the Balanced Scorecard seems to be the most influential concept in performance measurement field.

## The Balanced Scorecard

Public sector organizations, like private sector counterparts, are developing strategic plans and organizing their processes in order to attain the strategic objectives. With the motto "what gets measured gets done", they define measures of success for each objective and focus on the priorities and track progress in achieving results. On the other hand, public organizations have to realize what matters to citizens. Therefore, it is important to find an appropriate balance between citizen-driven and managerial-driven measures of performance.

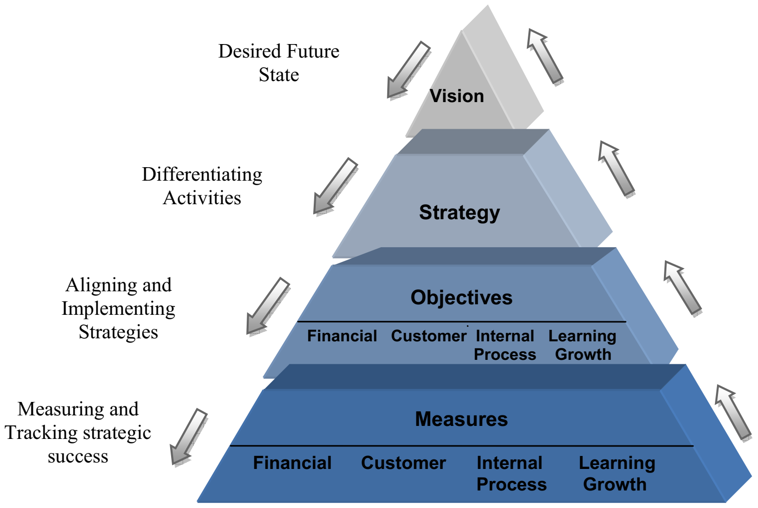
One of the useful frameworks linking strategy to performance is the balanced scorecard (BSC) model developed by Dr. Robert Kaplan and Dr. David Norton in the early 1990's. According to them the BSC includes four perspectives:

1. Customer perspective
2. Internal processes perspective
3. Learning and growth perspective
4. Financial perspective

Each goal in each area is assigned one or more measures, as well as a target and initiative. These measures can be thought of as key performance measures, measures that are essential for achieving a strategic choice. As explained by Kaplan and Norton (1992), the scorecard balances "outcome measures-the results from past efforts- and the measures that drive future performance". As a result of continued research and innovations over the last 15 years, the BSC has gone through an evolutionary process of improvement, performance measurement (1990-1996) to performance management (1996-2000), to becoming a globally recognized best practice for strategic management (2001-to present).

The BSC is a kind of strategic management system that is used extensively in business and industry, government, and nonprofit organizations worldwide to align activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic objectives. The following figure tells the translation between strategy and performance.

**FIGURE 1:** Translating strategies into performance



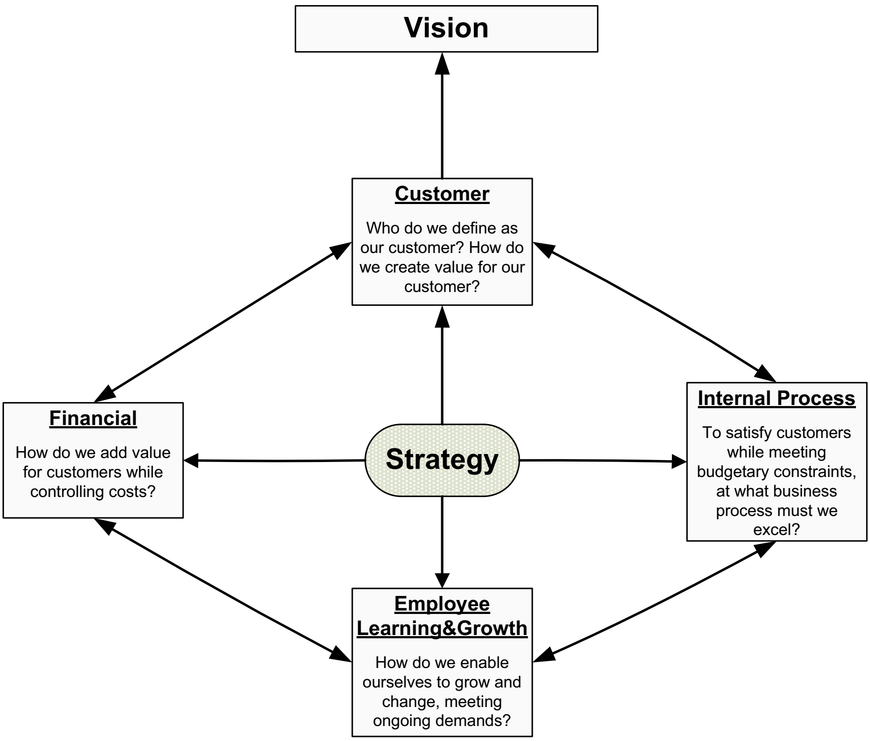

**Source:** Paul R. Niven, Balanced Scorecard Step-By-Step, Maximizing Performance and Maintaining Results, 2002, John Wiley and Sons

The arrows in the figure indicate that the BSC is both top-down and bottom up process. It is a kind of learning process, because the objectives and measures tell the way how vision and strategy should be achieved, after some time the results tell the effectiveness of strategy implementation. In this context, the BSC assists organizations in overcoming two fundamental problems: effectively measuring organizational performance and successfully implementing strategy. The performance measures selected for the scorecard represent a tool for leaders to use in communicating to employees and external stakeholders the outcomes and performance drivers by which the organization will achieve its strategies.

Linking strategies to performance measures via a strategy map is the basis for developing the BSC for an organization. According to Kaplan and Norton, strategy maps provide a visual representation of an organization's critical objectives and the crucial relationships among them that drive organizational performance. For a public organization, the strategy map can show an investment in developing resources (human, technology etc.) which will improve internal processes and ultimately drive the performance required to accomplish its vision.

The vision describes the future state of an organization. It can be a useful component for an organizational change process because it crystallizes where that organization is going. Projecting the future state as vision then translating that vision into daily action can be seemed as an almost impossible challenge. Here, the BSC provides a structure for taking high-level aspirations and converting them into practical actions.

**FIGURE 2:** Balanced Scorecard for the Public and Nonprofit Sectors




**Source:** Adapted from Paul R. Niven (2003), Adapting The Balanced Scorecard to Fit The Public and Nonprofit Sector

Strategy is at the core of the BSC. Describing the strategy means to draw the route map illustrating main objectives in four perspectives of the scorecard. Nevertheless, organizations in the public sector often have a difficulty to define a clear strategy. On the other hand, once strategy is developed, the BSC serves as the device for effective translation and implementation.

In the public sector, the matter "who is the customer" is also a challenge, because the legislative body that provides funding but the group who is served is public. Also, many would argue that constituents are the ultimate beneficiaries of policing activities and therefore the real customers. It can be defined customers here as the people who you "serve" and "benefit" from the services. As for financial measures, in the public sector BSC model can best be seen as either enablers of customer success or constraints (budget, legislation etc.). Working efficiently and creating value at lowest cost is of critical importance. The organizations in the public sector use many accounting and evaluations techniques in order to monitor costs and control them in the future. The key internal processes to mention in the BSC are the processes which drive value for customers. These processes lead to improved outcomes for customers. However, the notion of a value creation is new in the public sector, because simply meeting budgets and not creating any significant control issues are the main drivers. The processes in the BSC mainly can be derived from the objectives and measures defined for the customer perspective.

In the BSC framework, the organizations in the public sector develop measures for the employee learning and growth perspective in order to meet the objectives established in the customer, financial and internal process perspectives. Since, success in driving process improvements, operating in a fiscally responsible manner, and meeting the needs of all customer groups depend on the ability of employees and the tools. Motivated employee with the right talents and the right managerial tools creating an organizational climate designed for sustaining improvements are the key factors for employee learning and growth. There are areas particularly relevant for this perspective. First one is employee talents, defined as skills and competencies. Second one is the flow of information. In other way, employees should have the tools and information they require to make effective decisions that impact customer outcomes. Finally, the organizational climate should be addressed. This typically consists of elements such as alignment and motivation.

The usage of the BSC by public sector organizations is becoming prevalent as the importance of the achievement of strategy and improvement of performance increases. The United States (USA), United Kingdom (UK), Australia and Scandinavia are some of the countries where the BSC is a popular management tool.

## Challenges in the Development of the BSC in the Public Sector

Before defining challenges for the BSC, it should be noted that answering to multiple stakeholders with varied needs is a challenge for public sector organizations with limited resources.

First of all, cultivating a clear and concise strategy as well as the vision and mission of the organization is important to develop the BSC. Then, for public organizations, unlike private sector organizations which are seeking for profit, meeting the needs of stakeholders including customers and constituents are the main criteria lying behind the success of these organizations. Therefore, customer perspective sits at the top of the BSC to highlight the outcomes for key stakeholders. Financial considerations can play an enabling or constraining role, but will rarely be the primary objective for these organizations. So, the financial perspective for a public organization should not be at the bottom of the BSC, because money is important to be managed as effectively and efficiently as possible to deliver the strategic objectives. These objectives defined for stakeholders must be tangible. The two remaining BSC perspectives (internal processes and employee learning and growth) stay between other perspectives. Any public sector, government and not-for-profit organization needs to build the necessary human, information and organizational capital to deliver its key processes.

Then the application process steps in. In this process, there are two important tools: the resource allocation and budgeting process, the performance management process. A well designed BSC should describe the organizational strategy through the objectives and measures, linked together in a chain of cause-and-effect relationship. Therefore, the BSC can draw the overall picture for customers and other stakeholders inside the public organization.

As for the alignment process realizing performance management initiatives in a public organization, top management must effectively and clearly communicate strategies. From the “bottom”, employees need to understand the benefits of performance management as well as their roles in the effort and how it maps to the success of the organization. Cascading the strategy through the BSC, driving to lower levels and giving people the feeling that they contribute to the organization’s vision to be realized is the main idea lying behind the success of BSC.

In spite of benefits stated before several times, public sector organizations encounter many challenges while implementing strategy and improving performance. Some of these are (Bush, 2005; p.24):

- strategies that do not focus or prioritize organizational goals
- no ability to offer incentive compensation tied to performance achievements of employees and therefore must rely on intrinsic rewards for performance achievement
- difficulty in articulating the causal linkage because desired results are frequently enormous to be measured or evaluated

In addition, there is a common political practice that dictates a new administration is not willing to sustain the former state, refuses everything that has been initiated before whether they are good or bad practices. Therefore, a new system like performance measurement can be initiative for which has been lost energy.

# CONCLUDING REMARKS

Improving performance through a well-prepared planning, better processes and strong commitment by staff are the main themes for serving excellence in an efficient way in the 21st Century.

Among the public sector organizations, good governance for a state owned enterprise is critical because of their contribution to a country's overall economic efficiency and competitiveness as well as political importance. State owned enterprises (SOEs) are generally defined as "state companies operating in economic field by using public resources" and they are represented as "enterprises whose management control is held by central or local public administrations" in the legal texts and documents published by European Union, International Monetary Fund and Organization for Economic Cooperation and Development (OECD). SOEs are especially prominent in such sectors as transportation, electricity, gas, water supply, broadcasting, natural resource extraction, telecommunications, banking and insurance.

Over the past 20 years, despite extensive privatization, SOEs remain important in many developing countries. Unlike the past, SOEs today face much higher pressure to increase operational and financial performance. In response to pressures like demanding environment, international agreements, greater competition, and many countries have initiated corporate governance reforms of state-owned sector.

Governments have varying structures for managing the operations of their SOEs. There are three type structures: a decentralized model, a dual model and a centralized model. In a decentralized model, SOEs are under the responsibility of relevant sector ministries. However, in a dual model, the responsibility is shared between a sector ministry and a central ministry or an entity, usually the ministry of finance or the treasury. Finally, in a centralized model, the ownership responsibility is centralized under one ministry, organization or intergovernmental entity.

From my own consulting experiences in a SOE, defining stakeholders and the processes for these stakeholders seem to be clear and easier compared to other governmental organizations. Regardless of their managerial structure mentioned above, SOEs are established to produce services for a specific need. According to this, the users of that need, the processes creating value for the users are well-defined at the beginning. Also, financial performance and added value on capital investment are more visible to follow for both internal and external stakeholders including government. Therefore, developing the strategies and measures for processes and customer perspectives in a SOE can be simple. In addition, for the governments objectives related to SOEs, the profitability of SOEs using the BSC methodology can be easily tracked.

In order to develop a BSC for a public sector organization whether it is a SOE or other type public organization, it should be structured in the way that developing accountability, transparency, elasticity, performance based and strategic management in decision making processes. In this regard, they should prepare strategic plans for next years, defining vision, goals and objectives, aligning these goals and objectives with the budget through measures.

As a conclusion, governments and SOEs around the world are financially and resource constrained, yet governments and the SOEs are being called upon to provide better services to more people often for cheaper prices. The BSC is an important performance management tool and strategy execution methodology that enables enterprise managers to move their organizations toward achieving long-term, sustainable success.

## Acknowledgements

This paper was prepared on behalf of TÜBİTAK TÜSSİDE. The opinions expressed herein do not reflect the official views of TÜSSİDE, especially the implications for SOEs are based on the experiences and observations of the Consultant through the projects conducted in the Turkish public sector.

# REFERENCES


Armstrong, M. and Baron, A. (1998), Performance Management - the new realities, *The Institute for Personnel Development*, London.

Behn, R. D. (2003), Why measure performance?, *Public Administration Review*, 63(5), pp.586–606.

Bertucci, G. and Alberti, A. (2003), Globalization and the role of the state, in Rondinelli , G. and Cheema, S. (eds), *Reinventing Government in the Twenty First Century: State Capacity in Globalizing World*, Kumarian Press Inc., Bloomfield, CT.

Boland, T. and Fowler, A. (2000), A systems perspective of performance management in public sector organizations, *The International Journal of Public Sector Management*, 13 Issue 5, MCB University Press.

Boyne, George A. (2003), What is public service improvement?, *Public Administration* 81, pp. 211–227.

Bryson, J.M. (2004), Strategic Planning for Public and Nonprofit Organizations: A Guide to Strengthening and Sustaining Organizational Achievement, 3rd ed., Jossey-Bass, San Francisco, CA

Bush, P.(2005), Strategic Performance Management in Government: Using the Balanced Scorecard, *Cost Management*, 19,3, pp.24.

Curristine, T. (2005), Government Performance: Lessons and Challenges, *OECD Journal on Budgeting,* 5 (1)

Drucker, P.F. (1973), Management: Tasks, Responsibilities, Practices, New York.

Feit, D. (2003), Measuring Performance in the Public Sector, *Cost Management*, 17, 2, pp. 39

Faucett, A. and Kleiner B. H.(1994), New Developments in performance measures of public programmes, *The International Journal of Public sector Management*, 7, 3, pp.63

Hall, J.L. (2007), Implications of Success and Persistence for Public Sector Performance, *Public Organization Review*, 7, pp.281–297

Hatry, H. (1999), Performance Measurement, Getting Results, Urban Institute: Washington DC

Jarrar, Y. and Schiuma G. (2007), Measuring Performance in the Public Sector: challenges and trends, *Measuring Business Excellence*, 11,4, pp.4-8

Kaplan, Robert S. (2006), Using the Balanced Scorecard in the Public Sector, Government Summit

______ (2002), The Balanced Scorecard and Nonprofit Organizations, *Balanced Scorecard Report*, pp. 1-4.

______ and Norton, D.P. (1996), The Balanced Scorecard: Translating Strategy into Action. Boston: Harvard University Press

______and Norton, D.P. (2000), Having Trouble with Your Strategy? Then Map It, Harvard Business Review, Vol. 78, pp. 167

Kreklow, S. R. (2005), Using Performance Measures to Improve Performance, *Government Finance Review,* 21, 6, pp. 52

Kushner, R. J, Poole, P.P. (1996), Exploring structure-effectiveness relationships in nonprofit arts organizations, *Nonprofit Management and Leadership*, 6(2), pp. 171-80.

Mankins Michael C. and Steele R. (2005), Turning Great Strategy into Great Performance, *Harvard Business Review,* July-August, pp.1-10

Marr, B. and Schiuma, G. (2003), Business Performance Measurement-past, present and future, *Management Decision*, 41,8, pp.680

Martinez, J. (2000), Assessing Quality, Outcome and Performance Management, 12, pp.3

Nash, Michael M. (1984), Managing Organizational Performance, San Francisco.

Niven, Paul R. (2002), Balanced Scorecard Step-By-Step, Maximizing Performance and Maintaining Results, John Wiley & Sons, Inc.

_____(2003), Adapting The Balanced Scorecard to Fit The Public and Nonprofit Sector, Retrieved from http://www.fovea.com on 19.02.2009

Nohria, N. and Joyce W., Roberson B. (2003), What Really Works, *Harvard Business Review*, 81, 7, pp. 43-52

Parhizgari, A.M. and Gilbert R. G. (2004), Measures of Organizational Effectiveness: private and public sector performance, *The International Journal of Management Science*, Omega 32, pp. 221-229

Parker, R. and Bradley L. (2000), Organizational Culture in the Public Sector: evidence from six organizations, The International Journal of Public Sector Management, 13,2,pp.125-141

Pestieau, P. (2009), Assessing the performance of the Public Sector, *Annals of Public and Cooperative Economics*, 80,1, pp. 133–161

Poister, T.H. (2003), Measuring Performance in Public and Nonprofit Organizations, Jossey-Bass

Porter, M. (1996), What is Strategy?, *Harvard Business Review*, Vol.74, November-December

Scott G.(2003), The Learning Government, *OECD Journal on Budgeting*, 3,2,p.55-69

**Reports**

Executive Session on Public Sector Performance Management, *Getting Results Through Performance Management,* Harvard University, Kennedy School of Government

OECD (1995), Governance in Transition: Public Management Reforms in OECD Countries

OECD (2005), Guidelines on Corporate Governance of State-Owned Enterprises

2007 Public Enterprises Report, Undersectretariat of Treasury Directorate General of State Owned Enterprises, August 2008

**Web Sites**

www.bain.com
www.balancedscorecard.org
www.bettermanagement.com
www.hks.harvard.edu
www.ifc.org
www.oecd.org
www.worldbank.org
www.tbmm.gov.tr
www.treasury.gov.tr
www.mod.uk

# *TOTAL QUALITY MANAGEMENT*
# *&*
# *SERVICE QUALITY MANAGEMENT*

# TQM IN NEW CAR DEALERSHIPS: IT MAY BE CONSIDERED STRATEGIC BUT IS IT PRACTICED?

**Kym Fraser**
**University of South Australia, Australia**

## ABSTRACT

*New car dealerships play an integral role in the initial and on-going relationship between the purchaser and vehicle manufacturer. Evidence, mostly anecdotal, suggests that the buying and servicing experience of the paying public in regards to automotive dealerships is far from ideal. With continuous improvement systems such as TQM firmly embedded into the supply side of the car industry, questions still exist surrounding the level of quality being adopted by car dealerships. The purpose of this paper is to establish if quality is a pursued culture within new car dealerships and determine if key TQM principles such as top management support, customer focus, process management, and employee involvement are practised factors. Results indicated a reasonably high level of commitment to quality within dealerships, including the important success factors of TQM. Questions still remain about quality endorsement, the type of quality systems being used, and the depth of penetration of quality at the ground level.*

***Keywords:*** *Total quality management, automotive dealerships, critical success factors, empirical study, Australia*

## INTRODUCTION

One of the most important contributions to competitive advantage in recent years derives from an organisation's quality strategy. The findings of a joint study 'Excellence in Quality Management' undertaken by the automotive supply industry in Europe, the USA, Japan and Germany found that "companies can only be successful in the long term if they place quality at the core of their corporate philosophy and strategy" (Rommel *et al.*, 1996, p.ii).

The level of quality demanded by new car owners is continuing to rise, increasing the pressure on manufacturers and dealerships alike to provide better quality products and services (Hulett, 2008). While the manufactured quality of cars has greatly improved over the past few decades, the quality provided by dealerships is still being questioned. Dealerships form an important link in the value system of the automotive industry, which can be broken down into four major groups: component suppliers, car manufacturers, dealership networks and buyers. Dealerships represent the car manufacturers at the point of sale and act as a means of continuous contact between the car producers and the customers, long after the customer has taken delivery of the vehicle.

Evidence, some of which is anecdotal, tends to indicate that there is reluctance within many new car dealerships to embrace quality principles, leading to a less than desirable experience for customers buying and servicing motor vehicles. Joetan and Kleiner (2004, p.49) state "Automobile salespersons have long been viewed by the general public as cunning and cold". Sinha (2006, p.8) discusses the need for improved quality in an article titled "Quality needed at more car dealerships". In a survey by the Harvard Business School, automotive servicing and repair was found to be among the most unpleasant experiences faced by American consumers (Andaleeb & Basu, 1994).

One way for dealerships to improve their level of service and develop a quality culture is to implement a total quality management philosophy throughout their organisations. This proven business strategy has been successfully employed by many organisations around the world, not only improving quality of products and services but also reducing business costs. It is now recognised that firms which foster a culture of quality service through TQM are more successful than firms that do not (Kumar *et al.,* 2009). Evans and Lindsay (2002, p.10) state that while "many organizations have integrated quality principles so tightly with daily work activities that they no longer view quality as something special. Unfortunately, many other organisations have barely begun". This study will test if this is the case in regards to new car dealerships.

Therefore, the aim of this paper is to empirically test if a quality culture is being developed within the dealership network in South Australia by firstly; establishing if quality is a practised management philosophy within dealerships, and secondly, testing a number of key principles of TQM such as: the support and commitment from top management, customer focus and satisfaction, process management, and employee involvement.

# LITERATURE REVIEW

## Automotive industry, car dealerships and the perceived problems

The automotive industry is one of the oldest industries in the world. The wellbeing of the industry has long been seen as an indicator to the health of the general economy in many developed countries. It is not just the manufacturing of cars and car parts but the marketing, selling and after-sale service have an equally enormous impact on the economy. In 1999, 18 million automobiles were sold in the United States. In the same year, car manufacturers spent about $8.3 billion advertising aimed directly at prospective car buyers (Spaulding & Plank, 2007).

The role of the service sector is also paramount in both the economy and automotive dealerships. The service sector dominates the United States economy in terms of share of the gross domestic product and the number of jobs generated (Lohr, 2006). In the retail automotive sector, about 70% of the dealership's gross profit comes from service, parts and body operations (Kachadourian, 2005).

In global terms, the car industry is one of the most globalised industries in the world, employing upwards of 20 million people and has been a long-standing driver of economic prosperity (Strategic Direction, 2002). The car industry also plays an important and major role in the Australia economy, contributing an annual turnover of over $88 billion and the employment of over 230,000 Australians (MTAA, 2002). In 2007, new motor vehicle sales in Australia topped 1 million units for the first time (ABS, 2009).

The role of car dealerships within the industry cannot be understated. Automobiles move from the manufacturer's assembly line to the consumers' driveway via new car dealerships. Therefore, car dealerships play an integral role in the initial and on-going relationship between the purchaser and vehicle manufacturer.

It is this relationship which has and continues to present challenges to the expectations of many new vehicle purchasers. Over the years there have been many anecdotal accounts told of perceived poor levels of service quality within both new and used automotive dealerships. Car salespersons, finance/business managers and service departments have each received a disproportional amount of criticism from the buying public over the years when compared to their other buying experiences. Joetan and Kleiner (2004) argue that there is a negative stereotype in the mind of the public when it comes to the professionalism of automotive salespersons. They state that car salespeople have long been viewed by the general public as cunning and cold. Merrick (1995) goes further by claiming that most people perceive the car salesperson only marginally better than serial killers. The stereotype is even worse for the used car salesperson.

It is established that about one-half of car buyers who leave a dealership unhappy with their sales experience will not buy the same brand again (Automotive News, 2003, p.50). This reflects the importance of sales and service staff within dealerships building successful and lasting relationships with buyers because customer satisfaction will impact service department patronage and future sales.

In describing a series of unpleasant experiences while buying a new car Hulett (2008, p.9) made the following comment "When I got back to my office with my new car, I had a voice message from the business manager. He wanted me to come back to the dealership – a 30 minute drive – to fill out two more forms. After several voice mails, I suggested he fax me the paperwork. When I received the forms, I realized that I had signed one of them at the dealership. My confidence in the dealership dropped even lower". In another example, Khanfar and Loudon (2008, p.106) stated "Even though the dealership was a member of the prestigious President's Club, unfortunately the personnel reflected a negative image that has become widespread within the new car industry". The authors go on to say that a "lack of understanding of customer wants and desires has cost the automotive business dearly in the poor perceived reputation they currently have" (p.107)

An analysis of complaints investigated by the Office of Consumer and Business Affairs (OCBA) in South Australia for the year 2001/02 showed that the motor vehicle industry attracted the third highest amount of investigations (out of 11 categories) after Residential Building Construction and General Consumer Products (OCBA, 2002, p.26-27). Complaints investigated by the OCBA range from the purchase of new and used motor vehicles, automotive repair and servicing, and spare parts and accessories. Further analysis of the OCBA data showed that the number one reason (out of 12 categories) for the complaint involved quality, clearly ahead of issues involving contracts and warranties (p.28). Six years on and quality still remains the number one reason why complaints are investigated followed closely by scams and schemes (OCBA, 2008, p.34).

Therefore, it would seem that issues involving quality and car dealerships still abound. The importance of quality products and quality service to consumers cannot be overstated. Rommel et al, (1996, p.2-3) states "even today, customers explicitly reward quality. There is, for example, a close correlation between the American J.D. Power Index (customer satisfaction with automobiles) and growth in the sales figures of different makes of car". While the quality of manufactured cars has no doubt made major improvements over the past few decades there still remains questions marks over the level of quality being adopted by new car dealerships. To demonstrate this point it was only recently, 2005, that a car dealership won the prestigious Malcolm Baldrige National Quality Award, the first dealership in the US to win such an award. Following the win, the editor of the American Society for Quality responded by titling an article "Quality Needed at More Car Dealership" (Sinha, 2006, p.8).

One way for dealerships to improve their level of service and develop a quality culture is to implement a Total Quality Management philosophy throughout their organisations. This proven business strategy has been successfully employed by many organisations around the world, not only improving quality of products and services but also reducing business costs.

## Quality and TQM

Over the past few decades quality has developed from a function of the production department into a corporate philosophy. Professor Klaus G. Lederer states that "[c]ompanies can only be successful in the long term if they make this philosophy their own and master the three dimensions of quality: strategy, core process management, and staff motivation" (Rommel et al, 1996, p.x). The McKinsey study 'Excellence in Quality Management' on which the book Quality Pays is based, finds there are still major differences in practice between quality companies and others. It goes on to state that "only companies dedicated to quality are successful, profitable, and on the road to growth" (Rommel et al, 1996, pii).

In explaining the dominance of Japanese products worldwide, Spenley (1992) states the following "their world-beating achievements are remarkable and it is essential to understand the reasons for the Japanese success in world markets – a success based on the application of Total Quality Management (TQM)" (1992, p.3). TQM represents an integrative approach to pursue customer satisfaction, and has generated a huge amount of interest in many sectors of the economy such as manufacturing, service, government, and education in many countries around the globe (Chin et al. 2001).

Although there are many definitions of TQM, there is a general consensus regarding the essential principles, practices, and values of TQM. van Schalkwyk (1998, p.124) explains that "TQM is an organisation-wide philosophy that strives to continually improve quality and customer service, while simultaneously pushing down costs". Isaksson (2005, p.197) defined TQM as "A constant endeavour to fulfil and preferably exceed, customer needs and expectations at the lowest cost, by continuous improvement work, to which all involved are committed, focusing on the processes in the organisation". Antony et al. (2002) described TQM is an integrative management philosophy aimed at continuously improving the performance of products, processes and services to achieve and exceed customer expectations. Antony et al. goes on to state that the primary focus of TQM philosophy is on the hands and minds that employ the tools and techniques rather than the tools and techniques themselves.

Bunning (1992, p.6) provides the following when commenting on why organisations should adopt TQM: "quality has the capacity to provide a strategic competitive advantage. Those organisations able to demonstrate product or service differentiation, with an ability to respond flexibly to customer needs and expectations and provide high-level performance in terms of quality, cost and delivery, put tremendous pressure on those organisations who have not yet moved down the TQM path". Other reasons cited by Bunning included the high cost of poor quality, estimated to range between 15 and 40 per cent of sales turnover for a company using traditional (non-TQM) methods, and the rising expectations of customers.

Many empirical studies have confirmed that organisations that have adopted a quality-oriented strategy have achieved improved productivity, greater customer satisfaction, increased employee morale, improved management-labour relations, and higher overall performance (Isaksson, 2005; Chowdhury et al., 2007; Sharma & Kodali, 2008; Kumar et al., 2009). In the context of TQM, it is essential that organisations identify the key critical success factors, which need to be given special attention for ensuring the successful implementation and on-going development of a TQM philosophy.

## TQM – Critical success factors

Critical success factors (CSFs) are those few things that must go well to ensure success for a manager or an organization, and therefore, they represent those managerial or enterprise areas that must be given special and continual attention to bring about high performance (Wali et al., 2003).

Due to the lack of a single universally accepted framework, many authors have sought to characterise TQM with their own set of principles. Dahlgaard et al. (1998) lists five characteristics:

1. Management's commitment (leadership)
2. Focus on the customer and the employee
3. Focus on facts
4. Continuous improvements
5. Everybody participates

van Schalkwyk (1998) found that the underlying key principles of TQM were customer focus, continuous improvement, management commitment and leadership, employee empowerment, and process management, and if implemented well would ensure that companies continued to meet their customers' rising needs and expectations. Wali et al. (2003) carried out a review of critical success factors of TQM in 12 studies between 1974 to 1995. While many factors were discussed Wali et al. found that the most popular CSFs identified were employee involvement, top management leadership and process management. In a more recent study Lewis et al. (2006) reviewed 10 studies between 1998 to 2003 in an attempt to identify critical success factors of TQM in small and medium-sized enterprises. The study consolidated a list of 46 criteria items into 12 factors with customer focus and satisfaction, process management, leadership and management commitment, and employee involvement ranking the highest.

In a study to determine the impact of TQM and organisational performance, Sohail and Hoong (2003) used a quality management criteria model with six factors, these being employee empowerment, customer involvement and satisfaction, process management, top management commitment, quality measurement and benchmarking, and strategy and planning.

Adding to the academic research on TQM has been the development of award models such as the Malcolm Baldrige National Quality Award (MBNQA), the European Foundation for Quality Management (EFQM) model, and the Australia Quality Awards (AQA) (now called the Australian Business Excellence (ABE) awards). These quality frameworks form the basis for judging in the Australia Quality Awards and other major quality awards around the world (AusIndustry, 1994; Foley et al, 1997; Anderson & Sohal, 1999).

The framework used by the Australian Quality Council for the Australia Quality Awards concentrates on seven key areas (Australian Quality Council, 1994, p.7):

- Leadership
- Policy and planning
- Information and analysis
- People
- Customer focus
- Quality of process, product and services
- Organisational performance

In a review of both academic-based and awards-based (international and national quality awards) frameworks, Sharma and Kodali (2008) found that top management commitment, customer focus/satisfaction, employee involvement, and process management clearly feature at the top of the list of core elements needed to achieve excellence in TQM.

While there are many factors associated with TQM it is clear from the literature that four principles are critical to its success. These four key principles are:

- Top management commitment
- Customer focus and satisfaction
- Employee involvement
- Process management

Many studies have investigated the principles and critical success factors associated with TQM (Foley *et al.*, 1997; Dahlgaard *et al.,* 1998; Sila & Ebrahimpour, 2002; Rahman & Sohal, 2002; Tari, 2005; Seetharaman *et al.,* 2006; Sharma & Kodali, 2008). In regards to the automotive industry, the literature shows that studies have been conducted on the quality of car component suppliers and automotive manufacturers (Shadur *et al.*, 1994; Zeller & Gillis, 1995; McDermott, 1996; Kawahara, 1997; Wilson & Collier, 2000), but research at the dealership level is very limited. The few studies found tended to focus on the relationship between customer and dealership, customer satisfaction and the buying experience (Bouman & van der Wiele, 1992; Ehinlanwo & Zairi, 1996; Poscino & Pollice, 2004; Joetan & Kleiner, 2004; Spaulding & Plank, 2007; Darley *et al*., 2008).

To reduce the gap in the research literature regarding quality in new car dealerships the following two research questions are proposed:

1. *What is the level of commitment to quality in new car dealerships in South Australia?*

   *To determine commitment three key areas will be evaluated:*
   - *Quality systems in dealerships*
   - *Quality meetings in dealerships*
   - *Systems management*

2. *Is TQM a practised management philosophy in new car dealerships in South Australia?*

   *To determine if TQM is practised four key factors will be evaluated:*
   - *Top management commitment*
   - *Customer focus and satisfaction*
   - *Employee involvement*
   - *Process management*

# METHODS

A questionnaire survey was designed to answer the two research questions proposed at the end of the literature review. To test the survey design, a pilot study was undertaken with selected key participants in the hope of uncovering any questionnaire design issues, which may not have been apparent to the researcher. A draft copy of the questionnaire was given to two service managers, a general manager and a dealer principal from four different dealerships within the Adelaide metropolitan area, and an interview was held with each participant. The feedback obtained from the pilot study was important in ensuring the readability and understandability of the survey was maximised, along with the likelihood of the questionnaire answering the proposed research questions (Denzin & Lincoln, 1998; Neuman, 2003).

The target sample for this study was all new car dealerships listed under 'Motor Cars – New' within the Adelaide Yellow Pages. The Adelaide Yellow Pages covers the Adelaide metropolitan and surrounding areas. Research shows that the Yellow Pages directory is the most used source of buying information for people in the Adelaide area when they are looking for a supplier of goods or services (Sensis, 2002). To overcome any bias, which may have occurred due to the fact that some dealerships may choose not to be listed in the telephone directory, the list of dealerships obtained from the Yellow Pages was checked by motor industry representatives to ensure that all dealerships within the target sample had been captured.

The target group for this study were Service Managers of new car dealerships. Service Managers were chosen for two main reasons. Firstly, Service Managers are responsible for the ongoing maintenance and repair of customers' vehicles and, therefore, the important issue of customer satisfaction over the warranty period of the motorcar and beyond. Secondly, Service Managers have a central role to play within car dealerships. The success of a Service department relies on the sales generated by the New and Used car departments therefore much time is spent ensuring that this important (internal) customer is satisfied with the level of service provided. On the other hand, the Service department is a major customer for the dealership's Parts department. Therefore, at an internal dealership level, most Service departments are both service providers and customers.

From the original listing of 105 dealerships, 38 listings were found to be part of either a multi-franchised or multi-location group. Another two listed dealerships were found to be no longer operating, therefore reducing the total number of Service Managers, available to be targeted by the survey, to 65. Each Service Manager of the 65 dealerships was mailed a questionnaire together with a covering letter and a reply-paid envelope. Forty-three Service Managers responded to the survey, providing a response rate of 66 per cent. Data analysis of the responses was carried out using the statistical package SPSS version 11.0.

# RESULTS

**1. What is the level of commitment to quality in new car dealerships in South Australia?**
The criteria used to determine if there is a commitment to quality in new car dealerships evaluated three key areas of the dealership:

- quality systems in dealerships
  - quality endorsed
  - quality systems
  - system type
- quality meetings in dealerships
- systems management

**1.1 Quality systems in dealerships**

*1.1.1 Quality endorsed*

| | Percentage |
|---|---|
| Number of dealerships that are quality endorsed/quality assured companies. | 60% |

*1.1.2 Quality systems*

| | Percentage |
|---|---|
| Number dealerships with a quality system/s in place. | 69% |
| Number of Service departments with a quality system in place. | 86% |
| Number of Parts departments with a quality system in place. | 62% |
| Number of dealerships that are either quality endorsed and/or the Service and/or Parts departments have a quality system in place. | 93% |

Of the six Service departments without a quality system in place, it was found that five of these were in the group of dealerships with the smallest number of employees, 1-20.

*1.1.3 System type*

| | ISO 9002 | RAA Approved | MTA Approved | Franchisor Requirements |
|---|---|---|---|---|
| Type of quality system/s dealerships have in place. | 45% | 52% | 62% | 62% |

ISO – International Standards Organisation
RAA – Royal Automobile Association
MTA – Motor Trades Association

*ISO 9002*
The ISO 9000 Series is an internationally recognised standard for quality management. It is essentially aimed at improving the quality management system of an organisation and the internal auditing requirements are a foundation for continuous process improvement. Independent external audits are also carried out to ensure quality standards are maintained and for quality assurance purposes (Swift, 1998; Evans & Lindsay, 1999).

*RAA Approved*

RAA Approved involves compliance with a set of standards and a code of practice, covering equipment levels, equipment standards, employee qualifications, service facilities, staff levels etc. Certification requires a customer survey to be undertaken to determine quality of service, and external audits of premises are conducted 6 monthly (Information faxed: 9 April 2006, 'Requirements for RAA Approved', RAA).

*MTA Approved*
MTA Approved is granted through membership of the association and compliance with a set of standards. Certification is obtained through an industry peer review process, and once certification is granted, external audits are only conducted to resolve disputes (Personal conversation: 8 April, 2006).

*Franchisor requirement*
Franchisor requirement involves the policies and procedures, supplied by the vehicle manufacturer, which dealerships must follow and carry out to maintain the franchisee licence. These policies and procedures include areas such as new car warranty and vehicle servicing. Further research would be necessary to identify the quality management arrangements for dealerships that the manufacturers' require.

*1.1.3 cont. – System type*

| | Percentage |
|---|---|
| Of the dealerships with a quality system/s in place, how many are using ISO 9002. | 45% |
| Of the dealerships with a quality system/s in place, how many are using either RAA Approved or MTA Approved. | 66% |
| Of the dealerships with a quality system/s in place, how many are using the franchisor requirements. | 62% |
| Of the dealerships with a quality system/s in place, how many are using either ISO 9002 or the franchisors requirements. | 90% |
| How many dealerships are required by the manufacturer to be quality endorsed to ISO 9002. | 21% |

**1.2 Quality meetings in dealerships**

| | Weekly | Monthly | 6 Monthly | Rarely | Never |
|---|---|---|---|---|---|
| How often would the dealership conduct meetings concerning quality issues? | 21% | 57% | 11% | 11% | 0% |
| How often would Service Managers discuss quality related issues with the staff they manage? | 35% | 51% | 12% | 2% | 0% |

| | Percentage |
|---|---|
| Number of dealerships that conducted either 'weekly' or 'monthly' meeting concerning quality issues. | 78% |
| Number of Service Managers that discuss quality issues with staff on either a 'weekly' or 'monthly' basis. | 86% |

**1.3 Systems management**

| | Percentage |
|---|---|
| Number of dealerships that have a designated person whose duties include maintaining and managing the quality system. | 74% |
| Number of Service departments whose staff are aware of the quality system and the areas which relate to them. | 100% |

**2. Is TQM a practised management philosophy in new car dealerships in South Australia?**
To answer research question number two, the study analysed four key factors of TQM:

- Top management commitment
- Customer focus and satisfaction
- Employee involvement
- Process management

**2.1 Top management commitment**

| | Every time | Most times | Sometimes | Rarely | Never |
|---|---|---|---|---|---|
| How often are quality related meetings/issues within the dealership attended/addressed by the Dealer Principal/General Manager. | 32% | 39% | 22% | 7% | 0% |

| | Percentage |
|---|---|
| Number of dealerships in which the Dealer Principal or General Manager personally addresses meetings on quality issues either ‘every time’ or ‘most times’. | 71% |
| Number of dealerships whose ‘top management’ conducts either ‘weekly’ or ‘monthly’ meeting concerning quality issues. | 78% |
| Number of dealerships whose Dealer Principal or General Manager is considered to be the driving force behind quality within the dealership. | 71% |
| Number of Service Managers that support a quality culture within the dealership by discussing quality issues with staff on either a ‘weekly’ or ‘monthly’ basis. | 86% |
| Number of dealerships whose ‘top management’ supports the quality process by having a designated person to maintain and manage the quality system. | 74% |

**2.2 Customer focus and satisfaction**

| | Percentage |
|---|---|
| Number of Service Managers who believe quality systems helps improve the Customer Satisfaction Index (CSI) rating of the dealership. | 98% |
| Number of Service Managers who believe a quality system helps reduce customer complaints. | 98% |
| Number of Service Managers who believe a quality system improves the standard of servicing and customer satisfaction within the Service department. | 95% |
| Number of Service Managers who believe that a quality system is **<u>not</u>** more relevant to the New and Used car departments than the fixed operations (Service and Parts departments). | 93% |

With 95 per cent of Service Managers believing a quality system will improve the service standards and customer satisfaction of Service departments, a common theme was also identified in the respondents comments as shown in the few expressed below:

> *“The quality system establishes a standard and a measure we can all relate to. Quality also becomes an established norm and develops a culture which everyone responds to”;*
>
> *“There is a sequence everyone is responsible for. This is traceable and therefore mistakes or poor performance can be identified and fixed”;*
>
> *“Our system monitors the quality of the service we provide directly to the customer. We follow up on all ‘poor quality’ results and look to find ways to improve. If we didn’t have a system, we could not measure nor determine our performance”;*
>
> *“Provides focus, consistency, continuous improvement. A quality system provides guidelines to maintain customer satisfaction by all staff at all levels”;*

*"Without any quality systems in place we would not survive";*

*"It is the No.1 priority to give quality service therefore quality is given high priority and is in focus at all times. This makes financial sense as repeat business is critical".*

**2.3 Employee involvement**

| | Percentage |
|---|---|
| Number of Service departments whose staff are aware of the quality system and the areas which relate to them. | 100% |
| Number of dealerships that conducted either 'weekly' or 'monthly' meeting concerning quality issues. | 78% |
| Number of Service Managers that discuss quality issues with staff on either a 'weekly' or 'monthly' basis. | 86% |

**2.4 Process management**

| | Percentage |
|---|---|
| Number of dealerships that have a designated person whose duties include maintaining and managing the quality system. | 74% |

# DISCUSSION

**1. Is there a commitment to quality in new car dealerships in South Australia?**

As discussed in the literature review, TQM assumes that quality is the outcome of all activities that take place within an organisation. Accordingly, all functions and all employees have to participate in the improvement process and, to ensure this, organisations need both quality systems and a quality culture (Wilkinson & Willmott, 1995). The following discussion will focus on quality systems in dealerships.

In regards to the spread of quality systems in dealerships, the survey identified that Service departments have the highest percentage of quality systems in place (86 per cent). This compares with 62 per cent of Parts departments and the 69 per cent of dealerships with a company-wide quality system. One reason which may have influenced the findings above is that the questionnaire was answered by Service Managers who, logically, would have a better understanding of their own departments and therefore are likely to feel more confident answering questions about issues which are under their direct control.

The survey also found that many companies have quality systems in place but are not a quality endorsed/quality assured company. Nearly one-third of dealerships which indicated that they have a quality system in at least one department were not quality endorsed or quality assured. This issue also showed up at the beginning of questionnaire when participants were asked to indicate if the dealership was a quality endorsed/quality assured company. Of the 19 (44 per cent) respondents who either indicated that the dealership was not quality endorsed (16) or gave a non-response (3), five (26 per cent) of these went on to give details about their quality systems.

These figures raise some issues in regards to the actual level of quality systems within dealerships and the linkage between quality systems and quality endorsement. Of the 43 dealerships that returned the survey, only three (7 per cent) indicated that the dealership was not quality endorsed and neither the Service nor the Parts department had a quality system in place. Interestingly, two Service Managers (5 per cent) indicated that the dealership was quality endorsed but neither the Service nor Parts departments had a quality system in place.

It must therefore be noted that some confusion may surround the meaning of the question asking whether the dealership is a quality endorsed or quality assured company. It is accepted that some companies may demonstrate a high level of quality in the products and/or services it provides without having the certified '5 ticks quality endorsed' sticker on the window, or any type of endorsement (RAA Approved, MTA Approved, etc). This in some ways is borne out by the fact that six Service Managers (14 per cent) indicated that their dealership was not quality endorsed but that both the Service and Parts departments had quality systems in place, and why others choose to indicate that the dealership was not quality endorsed but carried on to answer questions within the section. This highlights the fact that some companies may in fact practice a quality philosophy or have a quality system in place, but not be a quality 'certified' company. As identified in the study on business performance, ISO 9000-certified companies did not perform significantly better than the companies that were not certified (Terziovski *et al*, 1999). Therefore, using quality endorsement as a measure to a firm's commitment to quality must be viewed with caution.

The literature indicates the ISO 9000 can help in a company's development towards TQM. The study found that less than half (45 per cent) of the dealerships with a quality system had ISO 9002. Some question must be asked about the quality value of endorsements such as RAA Approved and MTA Approved. ISO 9002 is an internationally recognised system while RAA Approved and MTA Approved are not systems as such but certification that a minimum standard has been achieved.

Another point of interest in regards to the use of ISO 9000 was to test if manufacturers required their dealerships to be quality assured to this standard. The literature demonstrated the pressure being applied to components suppliers from manufacturers ('backward looking') to improve their standard of quality, but this study found that there does not seem to be the same 'forward looking' pressure on dealerships. The results of this study indicated that only 21 per cent of dealerships were required to be quality endorsed to ISO 9002.

The use of quality systems as criteria to evaluate the level of commitment to quality in dealerships was done for two main reasons. Quality systems are identifiable and have close links to the development of TQM within an organisation. As discussed in the literature, it is not easy to measure how successful an organization's quality management is, therefore the focus is on whether an organisation has achieved some form of certification such as ISO 9000 (Noronha, 2002).

It would be true to say that many of the dealerships surveyed in this study display quality endorsed/quality assured signs on or around their dealerships. The real challenge for new car dealerships is not to say they are a quality organisation, but to demonstrate quality in the goods and services they provide. IBM's CEO John Akers expressed it well: "I am sick and tired of visiting plants to hear nothing but great things about quality and cycle time – and then to visit customers who tell me of problems. We hear lots of talk about quality, but as long as customers are still complaining, we haven't reached our goal" (Jablonski, 1992, p.11).

## 2. Is TQM a practised management philosophy in new car dealerships in South Australia?

### 2.1 Top management commitment

Firstly, the study examined the regularity with which the senior management conducts meetings regarding quality and the role played by Principals/General Managers at those meetings. The study then explored the perception within dealerships in regards to Dealer Principals/General Managers providing leadership, and lastly, the support senior management provides for maintaining and controlling the system within the dealership. In reference to the meaning of 'top management', both Service Managers and Dealer Principals/General Managers are included in this heading.

Fox (1991, p.10) states that " the most common observation expressed by people at all levels in a company which embarks upon the TQM process is: 'I will believe the company is serious about quality when "they" provide some evidence that "they" are prepared to apply the TQM concepts'. 'They' can be anyone from a first-line supervisor to the board of directors".

From this viewpoint, the study found that 'top management' held meetings concerning quality either 'weekly' or 'monthly', 78 per cent of the time, with 'monthly' the most popular at 57 per cent. To determine if Dealer Principals or General Managers attended such quality meetings and whether their attendance was more than a symbolic gesture, the study found that 71 per cent of Dealer Principals/General Managers did in fact attend and address quality meetings either 'every time' or 'most times'.

To determine if quality information flowed on to the lower level of car dealership, the study found that 86 per cent of Service Managers discuss quality related issues with the staff they manage either on a ‘weekly’ or ‘monthly’ basis, with ‘monthly’ being the most popular time period at 51 per cent.

Another measure used to determine the commitment of ‘top management’ to quality, was to test the perception within dealerships of the Dealer Principals/General Mangers attitude towards building a quality philosophy. The study found that 71 per cent of respondents believed that the dealership’s most senior manager was considered to be the driving force behind developing a quality culture within car dealerships.

To complete the evaluation of whether a quality philosophy is supported by ‘top management’ in dealerships, a question about the allocation of resources was asked in relation to supporting the quality system. The study found that 74 per cent of dealerships have a designated person whose duties included maintaining and managing the dealerships quality system/s. The question is important in that it is an indication of how serious senior management are about quality within the dealership. If ‘top management’ feel quality is important enough to incur the costs of having a designated person to maintain and manage the system, it is therefore saying that they are serious about the process and the benefits it can provide.

**2.2 Customer focus and satisfaction**

Many new car dealerships are placing increasing importance on Customer Satisfaction Index (CSI) ratings (Lovelock, 1992, p.80-81). CSI ratings are determined from the results of surveys sent from the vehicle manufacturer to the new car owner. Most manufacturers send out two surveys, one four weeks after the date of delivery, and another one between 9 to 15 months after date of purchase (or after at least one service has been performed). This allows the manufacturer to produce a customer satisfaction rating for each dealership within its network in regards to the customers purchasing experience and after-sales service. Dealerships gain prestige from winning CSI awards and receive financial benefits from manufactures (increased warranty labour rates).

In regards to the issue of improving the dealerships CSI ratings and quality systems, the study found that 98 per cent of Service Managers believed a quality system improved the CSI rating of the dealership.

The literature review identified that the average company loses as many as 35 per cent of its customers each year, of which about two-thirds are lost because of poor customer service. Profits can be greatly improved if only a small percentage of these customers can be retained by the company (Evans & Lindsay, 2002). Also identified was the fact that most dissatisfied customers did not complain (Denton 1989). Customer retention is a key factor for competitive success and is closely tied to quality and customer satisfaction (Evans & Lindsay, 1999). In an effort to establish if there was an understanding of the importance within new car dealerships of the link between customer satisfaction, customer complaints and quality systems, the study found the following. In regards to customer complaints, 98 per cent of Service Managers believed that a quality system helped to reduce customer complaints. When asked about customer satisfaction, 95 per cent of Service Managers believed that a quality system improved the standard of servicing and customer satisfaction within the Service department.

In an effort to determine if Service Managers believe in a ‘total’ quality philosophy for dealerships, the question was asked if they believed a quality system would be more relevant to the ‘front-end’ (New & Used car departments) of a dealership than the ‘back-end’ (Service and Parts departments). The study found 93 per cent of Service Managers indicated that quality systems were not more relevant for one department compared to another, therefore adding support to the results above and also showing that Service Managers believe in the concept of quality being throughout the whole dealership, a ‘total’ quality philosophy.

**2.3 Employee involvement**

The importance of employee involvement to a total quality philosophy is highlighted within the literature review. In regards to TQM, employee involvement helps people understand quality principles and instils these principles into the corporate culture (Evans & Lindsay, 1999). In TQM, quality is everyone’s responsibility, and at a number of successful TQM firms, quality information is communicated directly to employees during monthly meetings. George & Weimerskirch (1994) go to explain that more frequent informal communication helps assure managers that everyone in the system is aware and involved. At the core of TQM lies also the idea that all individuals play a substantial role in quality improvement (Kelemen, 2003). This study examines three measures in relation to employee involvement within car dealerships.

To determine the level of employee awareness to quality issues within the Service department, the study found that all staff (100 per cent) were aware of the quality system and the areas which relate to them. In regards to the regularity that Service Managers have discussions with Service department staff on quality issues, the study found that 86 per cent of Service Managers have informal communication with staff on either a ‘weekly’ or ‘monthly’ basis. At a higher level within dealerships, management meetings about quality were held either ‘weekly’ or ‘monthly’ in 78 per cent of dealerships.

### 2.4 Process management

Process management is identified as being another critical factor of TQM (Sila & Ebrahimpour, 2002). Process management involves planning and administering the activities necessary to achieve a high level of performance in a process, and identifying opportunities for improving quality and operational performance, and ultimately, customer satisfaction. Included also is the continuing process of evaluating process performance and taking corrective action when necessary (Evans & Lindsay, 1999). Carefully examining processes shows how much easier work can be, which includes breaking down barriers between departments, and between people, so they can work together more effectively. Once work on a process is undertaken and the best way to do it decided, the new way must be documented and become standard practice. Fox (1991) discusses the need for most companies to appoint a co-ordinator or facilitator to administer and control the TQM process and systems. The study found that 74 per cent of dealerships had a facilitator to manage and control the various process issues discussed above.

## CONCLUSIONS

This study set out to determine, firstly, the level of commitment to quality and, secondly, if TQM was a practised management philosophy within new car dealerships. The anecdotal evidence paints a picture that many dealerships still have a considerable way to go until consumers endure a consistent and enjoyable experience when conducting business with dealerships. From a single state in Australia this study found that the level of commitment to quality in new car dealerships was reasonably high. Questions still surround issues such as quality endorsement and the type of quality systems being adopted by dealerships. The four critical success factors used to evaluate TQM were found to be well supported in the majority of dealerships. It was found that smaller dealership (1-20 employees) tended to have minimal to no quality systems in place. Further research is needed to determine the ‘quality’ of the quality systems being used in dealerships, and the depth in which quality and TQM is emerged and ingrained into the various levels of dealership life.

## REFERENCES

Andaleeb, S. & Basu, A. (1994), ‘Technical complexity and consumer knowledge as moderators of service quality evaluation in the automobile service industry’, *Journal of Retailing*, Vol. 70 No. 4, pp. 367-381.

Anderson, M. & Sohal, A. (1999), ‘A study of the relationship between quality management practices and performance in small businesses’, *International Journal of Quality & Reliability Management*, Vol. 16 No.9, pp.859-877.

Antony, J., Leung, K. & Knowles, G. (2002), ‘Critical success factors of TQM implementation in Hong Kong industries’, *International Journal of Quality & Reliability Management*, Vol. 19 No. 5, pp.551-566.

AusIndustry, (1994), *Quality Pays: A guide for small business*, Australia.

Australian Quality Council, (1994), *Australian Quality Awards Criteria*, Melbourne.

Australian Bureau of Statistics (ABS), (2009), *Sales of New Vehicles*, Cat. No. 9314.0, Available from: http://www.abs.gov.au

Automotive News (2003), ‘Sales staff can make or break the deal, study shoes’, *Automotive News*, Vol. 77 No. 6054, pp.50.

Bouman, M. & van der Wiele, T. (1992), ‘Measuring Service Quality in the Car Service Industry: Building and Testing an Instrument’, *International Journal of Service Industry Management*, Vol. 3 No.4, pp.4-16.

Bunning, C. (1992), *Total Quality Management*, International Management Centre, Australia.

Chin, K., Pun, K. & Hua, H. (2001), ‘Consolidation of China’s quality transformation efforts: a review’, *International Journal of Quality & Reliability Management*, Vol. 18 No. 8, pp.836-853.

Chowdhury, M., Paul, H. & Das, A. (2007), ‘The impact of top management commitment on total quality management practice: An exploratory study in the Thai garment industry’, *Global Journal of Flexible Systems Management*, Vol. 8 No.1/2, pp.17-29.

Dahlgaard, J., Kristensen, K. & Kanji, G. (1998), *Fundamentals of Total Quality Management*, Chapman & Hall, London.

Darley, W., Luethge, D. & Thatte, A. (2008), ‘Exploring the relationship of perceived automotive salesperson attributes, customer satisfaction and intentions to automotive service department patronage: The moderating role of customer gender’, *Journal of Retailing and Consumer services*, Vol. 15, pp.469-479.

Denton, D. (1989), *Quality Service*, Gulf Publishing Company, Houston.

Denzin, N. & Lincoln, Y. (1998), *Strategies of Qualitative Inquiry*, SAGE Publications, California

Ehinlanwo, O. & Zairi, M. (1996), ‘Best practice in the car after-sales service: An empirical study of Ford, Toyota, Nissan and Fiat in Germany – Part I’, *Business Process Re-engineering & Management Journal*, Vol. 2 No. 2, pp.39-56.

Evans, J. & Lindsay, W. (1999), *The Management and Control of Quality*, 4th edn, International Thomson Publishing, Cincinnati.

Evans, J. & Lindsay, W. (2002), *The Management and Control of Quality*, 5th edn, Thomson Learning, Cincinnati.

Foley, K., Barton, R., Busteed, K., Hulbert, J. & Sprouster, J. (1997), *Quality, Productivity and Competitiveness: The role of quality in Australia’s social and economic development*, The Wider Quality Movement, Australia.

Fox, R. (1991), *Making Quality Happen: Six steps to total quality management*, McGraw-Hill Book Company, Australia.

George, S. & Weimerskirch, A. (1994), *Total Quality Management: Strategies and techniques proven at today’s most successful companies*, John Wiley & Sons, New York.

Hulett, K. (2008), ‘Lessons learned from buying a new car’, *Journal of financial Planning*, May/June, p.9

Isaksson, R. (2005), ‘Economic sustainability and the cost of poor quality’, *Corporate Social Responsibility and Environment Management*, Vol. 12, pp.197-209.

Jablonski, J. (1992), *Implementing TQM: Competing in the Nineties Through Total Quality Management*, 2nd edn, Pfeiffer & Company, San Diego.

Joetan, E. & Kleiner, B. (2004), ‘Incentive practices in the US automobile industry’ *Management Research News*, Vol. 27 No.7, pp.49-56

Kachadourian, G. (2005), ‘Car makers fight for service customers’, *Tire Business*, April, p.6.

Kawahara, A. (1997), *The Origin of Competitive Strength. Fifty Years of the Auto Industry in Japan and the U.S.*, USA.

Kelemen, M. (2003), *Managing Quality: Managerial and critical perspectives*, SAGE Publications, London.

Khanfar, N. & Loudon, D. (2008), 'Dr. Talal's Honda', *Journal of the International Academy for Case Studies*, Vol. 14 No.4, pp.103-107.

Kumar, V., Choisne, F., de Grosbois, D. & Kumar, U. (2009), 'Impact of TQM on company's performance', *International Journal of Quality & Reliability Management*, Vol. 26 No. 1, pp.23-37.

Lewis, W., Pun, K. & Lalla, T. (2006), 'Exploring soft versus hard factors for TQM implementation in small and medium-sized enterprises', *International Journal of Productivity and Performance Management*, Vol. 55 No. 7, pp.539-554.

Lohr, S. (2006), 'Academia dissects the service sector, but is it a science', *New York Times*, 18 April, p.C1-4.

Lovelock, C. (1992), *Managing Services: Marketing, operations, and human resources,* 2nd edn, Prentice-Hall, New Jersey.

McDermott, M. (1996), 'The revitalization of the UK automobile industry', *Industrial Management & Data Systems*, Vol. 96 No. 5, pp.6-10.

Merrick, N. (1995), *People of Management*, 4 May.

Motor Trades Association of Australia (MTAA), (2002), *Annual Report 2002*, Australia.

Neuman, W. (2003), *Social Research Methods: Qualitative and quantitative approaches*, 5th edn, Pearson Education, Boston.

Noronha, C. (2002), *The Theory of Culture-specific Total Quality Management*, Palgrave, New York.

Office of Consumer and Business Affairs (OCBA), (2002), *Commissioner for Consumer affairs Annual Report 2001/2002*, Government of South Australia.

Office of Consumer and Business Affairs (OCBA), (2008), *Commissioner for Consumer affairs Annual Report 2007/2008*, Government of South Australia.

Rahman, S. & Sohal, A. (2002), 'A review and classification of total quality management research in Australia and an agenda for future research', *International Journal of Quality & Reliability Management*, Vol. 19 No.1, pp.46-66.

Rommel, G., Bruck. F., Diederichs, R., Kempis, R., Kaas, H., Fuhry, G. & Kurfess, V. (1996), *Quality Pays*, Macmillan Press, London

Roscino, A & Pollice, A. (2004), 'A statistical analysis of the customer satisfaction with car dealers' *Applied Stochastic Models in Business and Industry*, Vol. 20, pp.281-289

Seetharaman, A., Sreenivasan, J. & Boon, L. (2006), 'Critical success factors of total quality management', *Quality & Quantity*, Vol. 40, pp.675-695.

Sensis, (2002), '*Yellow Pages: Adelaide 2003 Market Information Booklet'*, Australia.

Shadur, M., Rodwell, J., Simmons, D. & Bamber, G. (1994), 'International best practice, quality management and high performance: inferences from the Australian automotive sector', *The International Journal of Human Resource Management*, Vol. 5 No.3, September.

Sharma, M. & Kodali, R. (2008), 'TQM implementation elements for manufacturing excellence', *The TQM Magazine*, Vol. 20 No. 6, pp.599-621.

Sila, I. & Ebrahimpour, M. (2002), 'An investigation of the total quality management survey based research published between 1989 and 2000: A literature review', *International Journal of Quality & Reliability Management*, Vol. 19 No.7, pp.902-970.

Sohail, M. & Hoong, T. (2003), 'TQM practices and organizational performances of SMEs in Malaysia', *Benchmarking: An International Journal*, Vol. 10 No.1, pp.37-53.

Sinha, M. (2006), 'Quality needed at more car dealerships' *Quality progress*, Vol. 39 No. 11, p.8.

Spaulding, D. & Plank, R. (2007), 'Selling automobiles at retail: Is empathy important?, *Marketing Management Journal*, Vol. 17 No. 2, pp.142-155.

Spenley, P. (1992), *World Class Performance Through Total Quality*, Chapman & Hall, London.

Strategic Direction, (2002), 'Peugeot, VW and Renault keep the wheels turning', *Strategic Direction*, Vol. 18 No. 7, pp.13-15.

Swift, J., Ross, J. & Omachonu, V. (1998), *Principles of Total Quality*, 2nd edn, St. Lucie Press, Boca Raton.

Tari, J. (2005), 'Components of successful total quality management', *The TQM Magazine*, Vol. 17 No. 2, pp.182-194.

Terziovski, M., Sohal, A. & Moss, S. (1999), 'Longitudinal analysis of quality management practices in Australia organisations', *Total Quality Management*, Vol. 10 Issue 6, pp.915.

van Schalkwyk, J. (1998), 'Total quality management and performance measurement barrier', *The TQM Magazine*, Vol. 10, No.2, pp.124-131.

Wali, A., Deshmukh, S. & Gupta, A. (2003), 'Critical success factors of TQM: a select study of Indian organizations', *Production Planning & Control*, Vol. 14 No.1, pp.3-14.

Wilkinson, A. & Willmott, H. (1995), *Making Quality Critical: New perspectives on organizational change*, Routledge, London.

Wilson, D. & Collier, D. (2000), 'An empirical investigation of the Malcolm Baldrige National Quality Award causal model', *Decision Sciences*, Vol. 31 No.2, pp.361-390.

Zeller, T. & Gillis, D. (1995), 'Achieving market excellence through quality: The case of Ford Motor company', *Business Horizons*, May-June, pp.23-29.

# THE RELATIONSHIP BETWEEN THE TOTAL QUALITY MANAGEMENT PRACTICES AND PERFORMANCE: AN EMPIRICAL STUDY OF TURKISH FIRMS

**Esin Sadikoglu-Cemal Zehir**
**Gebze Institute of Technology, Turkey**

## ABSTRACT

*While there are many success stories of the total quality management (TQM) practices, some TQM programs have failed and previous studies give mixed and unclear results about the relationship between the TQM practices and performance. Also, the effects of the TQM practices on the various types of performance measures are different. In conjunction with this, consistent research results among multiple studies performing variety of methodology prove the strength and generality of the results of the research. There is no extensive empirical evidence about the effects of the TQM practices on the employee performance and innovation performance. The study used the critical factors of total quality as leadership, training, employee management, information and analysis, supplier management, process management, customer focus, and continuous improvement after exhaustive literature review. We used cross-sectional survey methodology with the unit of the sample being at the plant level. We obtained 373 usable questionnaires from ISO 9001:2000 quality assurance system certificated firms in different industries in the Marmara region in Turkey with 74.6 percent response rate. After conducting exploratory factor analysis, bi-variate correlation analysis, and confirmatory factor analysis, we made multiple regression analysis to figure out the relationship between the TQM practices and employee, innovation, and firm performance measures. The study obtained positive results. Discussions of the results, managerial and future research implications, and limitations were given.*
***Keywords:*** *Total quality management; Employee performance, innovation performance, and firm performance; Multiple regression analysis*

## INTRODUCTION

Total quality management (TQM) is a holistic quality improvement approach to firms by means of continuously improving the products, services, people, processes, and environment involving all employees to satisfy customers and maximize competitiveness of the firms. While there are many success stories of the TQM practices, some TQM programs have failed and previous studies give mixed and unclear results about the relationship between the TQM practices and firm performance (e.g. Kaynak, 2003; Nair 2006; York and Miree, 2004; Sadikoglu, 2004; Prajogo and Sohal, 2001, 2006; Rahman and Bullock, 2005; Fuentes et al., 2004; Chong and Rundus, 2004; Kannan and Tan, 2005; Douglas and Judge, 2001; Hung, 2007). Replication research contributes to empirical generalization or knowledge development to validate the cause-and-effect relationship, to integrate the empirical results of a discipline, and to develop theory by satisfying the criterion of reproducibility. Consistent research results among multiple studies performing a variety of methodology prove the strength and generality of the results of the research (cf. Nair, 2006; cf. Kaynak, 2003, 2008).

Firms should improve both quality and innovativeness to become competitive in the changing market place (Feng et al., 2006; Hung, 2007; Irani et al., 2004). Thus, continuous (incremental) improvement and innovation (breakthrough improvement) should be combined in the firm (Irani et al., 2004). Some scholars (e.g. Prajogo and Sohal, 2004; cf. Prajogo and Sohal, 2001; Kaynak, 2003) claim that the effects of the TQM practices on the various types of performance measures are different. Moreover, there is no extensive empirical evidence about the effect of the TQM practices on the employee performance (Sila, 2007). Some scholars suggested examine the effects of the TQM practices on employee performance (cf. Sila, 2007), on the level of innovation (e.g. Feng et al., 2006; Prajogo and Sohal, 2003, 2004), and on the various performance measures (e.g. Kaynak, 2003; Stashevsk and Elizur, 2000) in future study.

The objective of this study was to investigate the relationship between the TQM practices and employee, innovation, and firm performance measures. The organization of the paper is as follows. Section 1 introduces the importance and purpose of the research. Section 2 presents literature review and hypotheses to test the relationship between the TQM practices and performance measures. Section 3 presents research methodology, including survey instrument, data collection, and statistical analysis conducted. Section 4 gives the results of the data analyses, including sample demographics, reliability and validity of the constructs, and the results of regressions of TQM practices on performance. Section 5 presents discussions, indications of the results, further research implications, and research limitations. Final Section 6 gives conclusions of the paper.

# THEORETICAL BACKGROUND

The study used the critical factors of total quality as leadership, training, employee management, information and analysis, supplier management, process management, customer focus, and continuous improvement after exhaustive literature review (e.g. Sila and Ebrahimpour, 2003; Conca et al., 2004; Claver et al., 2003; Cua et al, 2001; Prajogo and Sohal, 2006; Black and Porter, 1995; Flynn et al, 1995; Saraph et al, 1989; Rungtusanatham et al, 1998; Ahire and Dreyfus, 2000; Fuentes et al, 2004; Rahman and Bullock, 2005; Sadikoglu, 2008; Das et al, 2000; Kannan et al, 2005; Benson et al, 1991; Pun, 2002; Wali et al, 2003; Goetsch and Davis, 2006; Besterfield et al, 2003). Exhibit 1 gives the definitions of the TQM practices. The importance of these factors is also highlighted in the Malcolm Baldrige National Quality Award (MBNQA) and the European Foundation for Quality Management (EFQM) Excellence Award (NIST, 2008; EFQM, 2008; Pun, 2002; Conca et al., 2004).

**EXHIBIT 1. DEFINITIONS OF THE TQM PRACTICES**

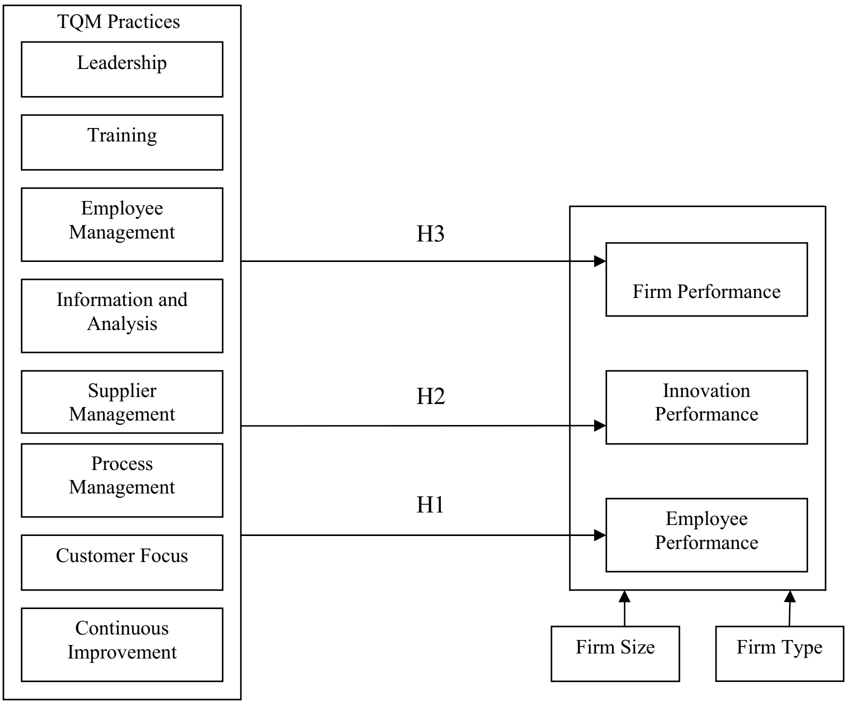
| TQM practices | Definition |
|---|---|
| Leadership | Management's role of maintaining and practicing a vision of the organization with respect to customer requirements as opposed to internal management control |
| Training | Technical skills (statistical process/quality control methods such as control charts and Pareto diagram, design tools such as design of experiments and quality function deployment), supervision skills (managerial problem-solving tools), communication, new work procedures (teamwork), and customer relations |
| Employee management | Coordination, effective open lateral communication, learning, cross-functional teams, flat organization, employee involvement in decision making and problem solving, empowerment, employee responsiveness in making suggestions for quality improvements, and employee recognition |
| Information and analysis | Quality costs such as internal failure costs of scrap and rework, and external failure costs of warranty and liability as well as statistical control charts to monitor processes, to identify quality problems, to provide information for process improvement |
| Supplier management | Working collaboratively and closely with a few selected suppliers and building a long-term relationship with trust and loyalty. Buyer should select suppliers on the basis of quality rather than solely on the basis of cost, and work with them to improve their quality practices |
| Process management | The set of methodological and behavioral practices that focus on actions and activities rather than results |
| Customer focus | Producing and delivering products or services that fulfill customers' present and future needs and expectations and even exceed their expectations to provide the organization long-term success and surviving |
| Continuous improvement | Searching for never-ending improvements and developing processes to find better methods in the process of converting inputs into outputs |

Source: Anderson et al., 1994; Flynn et al., 1994; Goetsch and Davis, 2006; Kaynak, 2003; Ho et al., 1999; Montgomery, 2005; Deming, 1986; Walton, 1986; Hackman and Wageman, 1995; Stevenson, 1996; Dean and Bowen, 1994.

# THE RESEARCH MODEL AND PROPOSED HYPOTHESES

Exhibit 2 shows the proposed research model on the relationship between the TQM practices and performance measures. Each line in the exhibit is labeled with its associated hypothesis, which is discussed in the following sections.

**EXHIBIT 2. THE PROPOSED RESEARCH MODEL OF THE RELATIONSHIP BETWEEN THE TQM PRACTICES AND PERFORMANCE MEASURES**




Employee performance means employee satisfaction, absenteeism, tardiness, commitment, motivation, and effort. Employee fulfillment means employees' feelings about satisfaction of their needs in the work. This is illustrated as job satisfaction, job commitment, and pride of workmanship. Pride of workmanship means the capability of the employees' feelings about delivering quality products and services to customers (Anderson et al., 1994).

Participative leadership sets a quality culture such that employees are considered as a valuable asset in the firm. Leadership motivates employees to direct employees' individual goals to the organization's goals to work harder. Employees do not feel fear and job insecurity in a total quality setting either. Top management initiates open communication between the employees and management, support employee involvement and empowerment so that the employees will feel a sense of ownership, self-actualization, loyalty to the organization, pride in work and satisfaction from work (Goetsch and Davis, 2006; Deming, 1986; Flynn et al., 1995). Thus, employees' continuous growth, learning, and development are facilitated in a total quality setting. Employees are not blamed for the problems occurred since about 85 percent of the problems are caused by the system, which is the responsibility of management. For this reason, employees are given training based on the training needs assessment to improve their skills and knowledge to help them do their jobs well (Goetsch and Davis, 2006; Deming, 1986).

Job characteristic viewpoint explains that the employees will feel more satisfied and absenteeism will be lower when their jobs include the core characteristics of skill variety, task identity (doing a meaningful unit of work), task significance, autonomy and feedback, which are the corners of effective employee management practices in a total quality setting (Hackman and Wageman, 1995). Quality circles or quality improvement teams will make the employees feel they are valued, respected, and important. Employee participation in decision-making and problem solving, soliciting their ideas for improving and developing existing and new products, services, and processes, empowering in managing daily work, and teamwork will improve the acceptance of the decisions and the changes made in the work place, employee commitment, quality of work life, turnover rate, absenteeism, employees' morale and motivation, their satisfaction from the job, and work performance (Flynn et al., 1995; Fuentes et al., 2004; Rahman and Bullock, 2005; Mohrman et al., 1995, Deming, 1986). Effective process management practices will also improve employee fulfillment (Anderson et al., 1994, 1995). Based on the reviewed literature, the following hypothesis is suggested:

**H1:** TQM practices are positively related to employee performance.

There are both negative and positive arguments about the relationship between the TQM practices and innovation performance in the literature. Some authors (cf. Prajogo and Sohal, 2001; Weirauch, 2006) state that employees of the TQM firms involve to improve the existing system incrementally by focusing on the details of the current quality process instead of on new ideas to change the current system of working substantially since they have pre-designed production system. Also, "management by fact" necessitates a set of data, tools, and techniques to analyze the existing system, leads to obtain prior solution based on the prior experience, and thus, prohibits producing innovative solutions. Moreover, the negative viewpoint states that process management practices focus on improving the process by eliminating waste to obtain efficiency and are not compatible with innovation. Promoting efficiency reduces slack resource, which is necessary in organizational innovation. Furthermore, customer focus leads organizations to incremental improvements of current products/services that will satisfy current needs of the existing customers rather than breakthrough (radical) improvements that will satisfy latent needs of current and future customers. This results in achieving product conformance rather than product innovation and constraining the firm's ability to innovate. In addition, continuous improvement inhibits breakthrough improvement (innovation) since it focuses on incremental change, necessitates standardization to establish control, stability, and routine, and prevents people from thinking radical changes in the organization.

On the other hand, there are positive arguments about the relationship between the TQM practices and innovation performance. Deming assumes any failure to meet the objectives is usually caused by the system and the system should be worked on to make it better. This brings new idea generation and cooperation at all levels bringing continuous improvement. Also, since the focus is on the system rather than the people to solve the problems, fear and mistrust have been eliminated in a total quality setting (Gluckman and Roome, 1993) so that the employees will contribute to new idea generation for innovating new products or services to delight customers. Furthermore, management is responsible for producing innovative products that will meet changing needs of the customers in a total quality setting. Leadership encourages employees to participate in the decision making, to suggest innovative ideas for solving problems and improving products, services or processes so that innovative behaviors will nurture and develop within the organization (cf. Prajogo and Sohal, 2001). Moreover, empowerment, employee involvement, teamwork, and employee mindedness will contribute to the success of organizational innovation, new idea generation, and risk taking to delight customers (cf. Prajogo and Sohal, 2001; Prajogo and Sohal, 2003, 2004; Goetsch and Davis, 2006; Noe et al., 2000). Also, providing and making decisions based on the relevant, reliable, high quality and timely data and information will contribute to introducing innovative products and services timely and effectively, and to benchmarking performance of the firm internally via performance management and externally with competitors. In addition, in today's rapid and continually changing environment, customers' needs and expectations also change. Focusing on the customer stimulates firms to delight customers by innovatively exceeding the customer needs and expectations with new products or services to survive and improve their competitiveness in the market. Thus, customer focus will encourage firms to search new customer needs and expectations, develop and innovate new products to continuously adapt to the market's changing needs (Prajogo and Sohal, 2001; cf. Prajogo and Sohal, 2003). Thus, the following hypothesis is proposed:

**H2:** TQM practices are positively related to innovation performance.

Customer satisfaction is the extent of the perceptions of the customers in meeting their needs and requirements by the products and services (Anderson et al. 1994; Evans and Lindsay, 1993). An organization's survival depends on satisfaction of its customers continuously (Deming, 1994, 1981-82, 1986; Brah et al., 2002) so that firms should use customer satisfaction to assess its performance (Madu and Kuei, 1993). Successful teamwork practices will increase employees' knowledge of jobs and consistency of employees' efforts, and improve firm performance such as reduced cost and improved quality continuously. Also, effective statistical analysis of the relevant, current, reliable, and accurate data and information will facilitate monitoring the management systems and processes for improving performance in a total quality setting (Gluckman and Roome, 1993; Corbett et al., 1998; Hackman and Wageman, 1995). Furthermore, successful supplier management practices will minimize total cost. Supplier performance with respect to variability of the suppliers' products, product quality, delay, and rework will improve by working with a few suppliers, providing them necessary training and technology, and monitoring their performances (Deming, 1986). Moreover, effective TQM practices will stabilize processes to improve quality, scrap, rework, and inventory levels to minimize production cost and cycle time. Reduced cycle time will improve delivery performance and productivity (Sila, 2007; McAdam and Bannister, 2001). Reducing process variation will increase output uniformity and decrease nonconforming products such as scrap and rework since quality problems are solved proactively (Anderson et al., 1994; Forza and Flippini, 1998; Ahire and Dreyfus, 2000). Regular preventive maintenance will increase reliability and reduce interruptions in the production process, thus, improve product quality (Ho et al., 1999).

Giving priority to customers' real requirement and future needs as a goal in the firm and close contact with customers to identify their needs continuously will satisfy customer in terms of improved quality products and services with reasonable prices, thus, improved operating performance, quality performance, and market share of the firm. Understanding and satisfying customer needs will lead to reduce defective product and costs. Customer focus will have a positive impact on relative product quality (Prajogo and Sohal, 2004), growth/share, profitability, and sources of performance improvement such as product loyalty of the firm. It will encourage firms to search the knowledge about customers' needs and expectations and to provide their customers added value (Fuentes et al., 2004).

Reducing the variation continuously will increase the output and reduce rework, mistakes, and waste of staffing, machine time, and materials. The TQM philosophy insists to improve performance continuously due to relentless competition. Continuously improving process, product or service quality will reduce scrap and rework cost, cut cost by eliminating waste and non-value added activities, and enhance productivity and lead-time of the firm (Kaynak, 2003; Anderson et al., 1994; Walton, 1986; Johston and Daniel, 1991). This will enable to obtain greater profitability by increasing profit margins (cf. Fuentes et al., 2004). Successful continuous improvement efforts will improve the processes, products or services to meet and satisfy changing customer demands and needs (Anderson et al., 1994; Rungtusanatham et al., 1998). Based on the reviewed literature, the following hypothesis is suggested:
**H3:** TQM practices are positively related to firm performance.

# RESEARCH METHODOLOGY

## Measurement Instrument and Sample

We adapted items for the TQM practices and performance measures from the studies of Rahman and Bullock (2004), Chong and Rundus (2004), Fuentes et al. (2004), Cua et al. (2001), Saraph et al. (1989), Kannan and Tan (2005), Prajogo and Sohal (2004), and Kaynak (2003). The questionnaire included a five-point Likert-type scale anchored at (1) strongly disagree and (5) strongly agree, indicating their disagreement or agreement with each item. We used cross-sectional survey methodology in this study and the unit of the sample was at the plant level. The sample was selected randomly among firms who have ISO 9001:2000 quality assurance system certificates in different industries in the Marmara region in Turkey. Although being ISO-9000 certified does not assure achieving real improvements in the quality of the processes, products or services and the TQM implementation in the firm (Taylor and Wright, 2003), it is compatible and a subset of TQM (Goetsch and Davis, 2006; Montgomery, 2005). We used ISO-certified firms as respondents considering they have had a head start on the TQM journey as used in literature (e.g. Conca et al., 2004). We sent 500 questionnaires to the firms in the years of 2005 and 2006, and promised them confidentiality of their responses of the questionnaire and sending the general firm profile in response to participating in the survey in the cover letter to obtain a high response rate. We requested perceived (subjective) data from the respondents to measure the intensity of the TQM practices and performance measures of the firm. Respondents completed the questionnaires mostly via face-to-face interview but they also participated in the survey by mail, e-mail, and fax. We obtained 373 usable questionnaires giving the response rate as 74.6 percent.

We conducted exploratory factor analysis (EFA) using principle components extraction with varimax rotation to identify factors with eigenvalues of at least one to obtain more easily interpretable factor loadings. We used independent and dependent variables (TQM practices and performance measures) together in EFA. We made bi-variate correlation analysis to identify the correlation among the TQM practices and between the TQM practices and performance measures. Firm performance measure included items related to operating performance, quality performance, and customer satisfaction. We used confirmatory factor analysis (CFA) to refine the resulting scales in EFA and to assess the unidimentionality and convergent validity of the measures. We added firm size and firm type variables to the equations as control variables. This will help make the results more believable and mitigate potential missing variable bias. We made multiple regression analysis to figure out the relationship between the TQM practices and employee, innovation, and firm performance measures.

# RESULTS OF THE ANALYSIS

## Sample Demographics

Exhibit 3 gives a descriptive summary of the respondents. The numbers in the parentheses in the Exhibit give percentages of the corresponding values.

**EXHIBIT 3. A PROFILE OF THE RESPONDENTS**

| | |
|---|---|
| Industry | Service (51.2%):<br>Transportation: 102, (27.3%)<br>Information technology: 44, (11.9%)<br>Finance: 27, (7.2%)<br>Healthcare: 14, (3.8%)<br>Other: 41, (1.1%)<br>Manufacturing (48.8%):<br>Textile: 40, (10.7)<br>Metallurgy: 24, (6.4%)<br>Food: 23, (6.2%)<br>Furniture: 12, (3.2%)<br>Other: 83, (22.3%) |
| Job title | Senior manager (top manager, vice manager, human resource manager, or total quality manager): 26, (7%)<br>Middle manager (department manager or chief): 98, (26.3%)<br>Low-level manager (foremen): 81, (21.7%)<br>Employee (engineer or technician):155, (41.6%) |
| Number of employees | Small (less than 150): 175, (46.9%)<br>Medium (between 150 and 250): 21, (5.6%)<br>Large (more than 250): 172, (46.1%) |
| Scope of operation | Regional: 28, (7.5%)<br>National: 232, (62.2%)<br>International: 106, (28.2%)<br>Global: 7, (1.9%) |
| Sector | Private: 366, (98.1%)<br>Public: 7, (1.9%) |

## Tests for Reliability and Validity of the Constructs

Internal consistency reliability of multiple item measurement scale is measured by Cronbach's alpha. We made reliability analysis to ensure that the scale items measured the corresponding latent variables consistently and were free of measurement error by using Cronbach's alpha (Cronbach, 1951), composite reliability index (Bagozzi and Yi, 1988), and average variance extracted index (Fornell and Larcker, 1981).

Exhibit 4 exhibits descriptive statistics, Pearson correlations, multicollinearity, and reliability estimates for the variables in the research model. It is easily noticed from the exhibit that Cronbach's alpha and scale composite reliability (SCR) values of all TQM factors and performance measures surpassed 0.70 thresholds. One exemption was that the reliability of innovation performance measure being 0.69 but this value still is acceptable since it is very close to the threshold. Also, average variance extracted values (AVE) of all variables exceeded 0.50 threshold. One exception was the AVE values of 0.47 and 0.45 for leadership and information and analysis practices, respectively. However, these values still are acceptable since they are very close to the threshold value. Thus, the constructs had satisfactory reliabilities.

### EXHIBIT 4. DESCRIPTIVE SCALES, CONSTRUCT BIVARIATE CORRELATIONS, COLLINEARITY, AND RELIABILITY ESTIMATES

| | Variables | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Leadership | -- | | | | | | | | | | |
| 2 | Training | 0.52 | -- | | | | | | | | | |
| 3 | Employee management | 0.59 | 0.59 | -- | | | | | | | | |
| 4 | Information and analysis | 0.63 | 0.48 | 0.49 | -- | | | | | | | |
| 5 | Supplier management | 0.50 | 0.39 | 0.52 | 0.46 | -- | | | | | | |
| 6 | Process management | 0.48 | 0.46 | 0.43 | 0.53 | 0.44 | -- | | | | | |
| 7 | Customer focus | 0.57 | 0.43 | 0.57 | 0.48 | 0.58 | 0.49 | -- | | | | |
| 8 | Continuous improvement | 0.47 | 0.44 | 0.45 | 0.45 | 0.47 | 0.42 | 0.41 | -- | | | |
| 9 | Employee performance | 0.47 | 0.47 | 0.59 | 0.45 | 0.48 | 0.40 | 0.48 | 0.47 | -- | | |
| 10 | Innovation performance | 0.26 | 0.24 | 0.32 | 0.29 | 0.34 | 0.21 | 0.37 | 0.25 | 0.34 | -- | |
| 11 | Firm performance | 0.48 | 0.40 | 0.52 | 0.46 | 0.53 | 0.43 | 0.53 | 0.49 | 0.61 | 0.39 | -- |
| | Variance inflation factor | 2.26 | 1.87 | 2.14 | 2.00 | 1.83 | 1.65 | 2.05 | 1.55 | NA | NA | NA |
| | Mean | 4.03 | 3.82 | 3.70 | 4.01 | 3.89 | 3.70 | 4.20 | 3.78 | 3.75 | 4.05 | 3.88 |
| | Standard deviation | 0.65 | 0.85 | 0.79 | 0.65 | 0.76 | 0.87 | 0.67 | 0.83 | 0.81 | 0.73 | 0.68 |
| | Cronbach's α | 0.82 | 0.89 | 0.84 | 0.76 | 0.87 | 0.84 | 0.88 | 0.75 | 0.81 | 0.69 | 0.82 |
| | Scale composite reliability | 0.82 | 0.89 | 0.84 | 0.76 | 0.87 | 0.84 | 0.84 | 0.75 | 0.82 | 0.69 | 0.82 |
| | Average variance extracted | 0.47 | 0.67 | 0.56 | 0.45 | 0.62 | 0.63 | 0.56 | 0.60 | 0.61 | 0.53 | 0.55 |

*N=373; All correlations are significant at the $p < 0.01$ level (2-tailed); NA means "Not Applicable".

Prior to multiple regression analysis, the validity of the model was tested. The items resulting from EFA were screened by conducting a CFA to determine whether they indeed measured their related TQM practices and performance measures. The measurement model for all factors was estimated without constraining the covariance matrix of the factors. Some items were eliminated to improve the model fit to the data in CFA. The confirmatory measurement model was found to be statistically acceptable at the 0.001 level of significance. The measurement model for the TQM practices and performance showed a good fit with an incremental fit index (IFI) of 0.94 and a comparative fit index (CFI) of 0.95 (with $\chi^2_{(687)} = 1212$, RMSEA = 0.05).

Content validity is the extent of coverage of the items in the issues measured. It is related with the subjective evaluation of the validity of the eleven dimensions in this study. These factors had content validity since their items were derived from an exhaustive review of the literature. Construct validity assesses how well the individual item measured the scale. We retained items that had a factor loading of at least 0.50 in EFA. Factor loading establish unidimensionality of the measures used in this study.

Convergent validity means the agreement of the items to measure the same construct. CFA can be used to assess convergent validity (Bagozzi et al., 1991). A test of each item's path coefficient in CFA was used to assess convergent validity. All items load significantly on their respective constructs (with the lowest t value being 5.08). Also, each item's coefficient was greater than twice its standard error. Thus, the measures indicated high convergent validity.

Discriminant validity shows the extent to which different factors are discrete. As easily noticed from Exhibit 4, the correlation coefficients between the TQM factors and performance measures are lower than the reliability coefficients so that the measures have discriminant validity. As also clearly seen from Exhibit 4, the estimated extracted variance for each construct is higher than the squared estimated correlation parameter between each pair of the constructs (Fornell and Larcker, 1981). Thus, discriminant validity is satisfied.

Criterion-related validity assesses the extent to which items in a construct correlated with an external variable. In this study, the TQM practices are the predictors and the three performance measures are the outcomes. As clearly noticed from Exhibit 4, the bivariate correlations of the TQM index with performance measures range from 0.21 to 0.59 being statistically significant at the $p < 0.01$ level. Thus, there is strong criterion-related validity.

As noticed from the results of bi-variate correlation, the TQM practices show significant and positive correlations with themselves indicating the interdependence of quality management practices. Relatively high multicollinearity between independent variables can cause difficulties in figuring out inferences based on regression estimates due to high standard errors of the estimated correlation coefficients. When r is less than or equal to 0.8, the obtained results will be close to the true values (Asher, 1983). As easily seen in Exhibit 4, the correlations among the TQM practices, which ranged from 0.39 to 0.63, were less than 0.8. In addition, we measured the variance inflation factor (VIF) to assess the inflation in parameter estimates due to collinearities among the TQM practices (multicollinearity) in the multiple regression analysis. Since the VIF values of all TQM variables, which ranged from 1.55 to 2.26, were less than 3, their multicollinearity did not have undue effect on the least squares estimates.

## Results of Regressions of the TQM Practices on Performance

Exhibit 5 gives the results of the regressions of the TQM practices on employee performance, innovation performance, and firm performance, respectively. As easily noticed from Exhibit 5 that the prediction models are all significant ( $p <$ 0.001) and the TQM practices account for 43 percent of the variance ( $R^2_{adj}$ = 0.43, F = 29.25) in employee performance, 17 percent of the variance ( $R^2_{adj}$ = 0.17, F = 8.37) in innovation performance, and 43 percent of the variance ( $R^2_{adj}$ = 0.43, F = 29.58) in firm performance, respectively.

### EXHIBIT 5. THE REGRESSION RESULTS OF THE TQM PRACTICES AND PERFORMANCE MEASURES

| | Variables | Employee performance | | Innovation performance | | Firm performance | |
|---|---|---|---|---|---|---|---|
| | | Standardized beta coefficient | $P$ -value | Standardized beta coefficient | $P$ -value | Standardized beta coefficient | $P$ -value |
| 1 | Leadership | 0.04 | 0.516 | -0.01 | 0.930 | 0.03 | 0.597 |
| 2 | Training | 0.10 | 0.056* | -0.01 | 0.864 | -0.00 | 0.955 |
| 3 | Employee management | 0.31 | 0.000**** | 0.09 | 0.208 | 0.20 | 0.001**** |
| 4 | Information and analysis | 0.07 | 0.184 | 0.11 | 0.112 | 0.08 | 0.149 |
| 5 | Supplier management | 0.09 | 0.096* | 0.16 | 0.015** | 0.16 | 0.002*** |
| 6 | Process management | 0.03 | 0.495 | -0.06 | 0.342 | 0.07 | 0.146 |
| 7 | Customer focus | 0.07 | 0.207 | 0.20 | 0.003*** | 0.15 | 0.007*** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 8 | Continuous improvement | 0.16 | 0.002*** | 0.04 | 0.524 | 0.18 | 0.000**** |
| | Firm type | -0.02 | 0.687 | 0.10 | 0.052 | -0.04 | 0.325 |
| | Firm size | 0.08 | 0.058 | -0.06 | 0.257 | 0.04 | 0.389 |
| | $R^2_{adj}$ | 0.43 | NA | 0.17 | NA | 0.43 | NA |
| | $P$-value | 0.000*** | | 0.000*** | | 0.000*** | |

* Denotes significant at $p < 0.10$; ** denotes significant at $p < 0.05$; ***denotes significant at $p < 0.01$; **** denotes significant at $p < 0.001$; NA means "Not Applicable".

# DISCUSSION AND STUDY IMPLICATIONS

As noticed from the results of bi-variate correlation, the TQM practices show significant and positive correlations with themselves indicating the interdependence of quality management practices. Firms that excel in one of the TQM practices are also likely to excel in the other TQM practices. Moreover, the results of the study give that all TQM practices are statistically significantly and positively correlated with employee performance, innovation performance, and firm performance (Exhibit 4).

We should note that different TQM practices are statistically significantly and positively related to varying performance measures while all being significantly correlated with performance (see Exhibits 4 and 5). The regression analysis results of the first prediction model in Exhibit 5 give that employee management, continuous improvement, training, and supplier management are statistically significantly and positively related to employee performance with their decreasing effects based on the associated standard beta coefficients, respectively. The results of the second prediction model give that the customer focus and supplier management are statistically significantly and positively related to innovation performance with their decreasing effects, respectively. Finally, the results of the third prediction model state that the employee management, continuous improvement, and supplier management are statistically significantly and positively related to firm performance with their decreasing effects, respectively.

Closer examination of the regression results in Exhibit 5 row by row indicate that leadership, information and analysis, and process management are not statistically significantly related to any of the performance measures. Training has a statistically significant positive effect on employee performance. Providing adequate and timely training to the employees based on the training needs assessment improves employees' skills and knowledge, their motivation, commitment, satisfaction, pride of workmanship, and employee's effort.

The results give that employee management has statistically significant positive effects on employee performance and firm performance. Treating employees as valuable assets and teamwork in the firm, soliciting employees' ideas for improving and developing existing and new products, services, and processes, employee participation in decision-making and problem solving, and empowering workers' in managing daily work improve employees' morale and motivation, their satisfaction from the job, and their work performances. Successful employee management efforts also improve quality performance, operating performance, and customer satisfaction.

The results of the study claim that supplier management has statistically significant positive effects on all performance measures. Cooperation between the supplier and different departments of the buyer and working with the supplier based on a long-term relationship, trust, and loyalty to improve quality practices brings a sense of ownership from the employees via participating in decision-making, increase employees' knowledge of jobs and consistency of their efforts. Effective supplier management efforts contribute to introduce new products or services in the market place timely and effectively to satisfy external customers. Working closely and sharing internal data with the supplier also improve quality performance, operating performance, and external customer satisfaction of both the supplier and buyer.

The results also give that customer focus has a statistically significant positive effects on innovation performance and firm performance. Focusing on customer enhances producing new innovative products and services to meet changing needs and requirements of the customers. Giving priority to customers' real requirement and future needs as a goal in the firm and close contact with customers to identify their needs continuously improve quality performance (scrap, waste, etc.), operating performance (inventory, cost, productivity), and customer satisfaction.

The results of the study give that continuous improvement is statistically significant and positive effects on employee performance and firm performance. Effective continuous improvement efforts improve employees' motivation, pride-of-work, work performance, quality performance, operating performance, and customer satisfaction.

Although not being the aim of this study, we should claim that continuous improvement and radical (breakthrough) improvement can coexist in a firm. While conventional wisdom states that the TQM practices are detrimental to innovation, we have not found any negative effect of the TQM practices on innovation performance. In fact, the study has found that supplier management and customer focus improves radical innovation performance of the firm. Firms can satisfy customers by continuously improving quality of the existing products or services as well as by innovating new products or services.

## Managerial Implications

Managers can use the model periodically to assess where their firm stands in the TQM journey. They can also measure the degree of the effects of the TQM practices on the various performance measures so that they can better evaluate the effectiveness of the TQM practices. The positive results between the TQM practices and the various performance measures can motivate the leaders of the firms to commit resources such as time, effort, and capital to implement the TQM practices to improve employee performance, innovation performance, quality performance, operating performance, customer satisfaction, and competitiveness of the firm.

## Research Implications

The regression analysis results of the study state that each TQM factor is significantly and positively related to some of the performance measures. The results also claim that leadership, information and analysis, and process management are not statistically significantly related to any performance measures. These insignificant relationships may imply mediating (indirect) effects of some TQM practices on the performance measures through the other TQM practices. Direct and indirect (mediating) relationships among the TQM practices and between the TQM practices and various performance measures can be investigated in future study.

Strategic quality planning is one of the key factors of the TQM practices. It can be added into the proposed model in future study. Also, multiple methods and multiple informants should be used in future studies to eliminate potential common method bias and improve the generalization of the findings. Moderating effects of contextual factors such as firm size, firm type, scope of operations, degree of competition, managerial knowledge, and ISO-9000 registration can be studied to evaluate complex relationships among these variables as well. Non-certified firms could also be included in the survey to figure out the interaction of ISO-9000 and TQM practices in future study.

## Research Limitations

The study has some limitations. First, the study collected perceived data about the actual TQM practices and performance measures. However, some respondents might give desired data. Also, about 63.3 percent of the respondents being low-level managers and employees (engineer or technician) might not correctly evaluate current levels of firm performance. This would bring concerns about generalizability, reliability, and validity of the study. Since the model is reliable and valid in terms of exceeding the required threshold, this bias would not cause serious problem. Moreover, the study did not use objective measures of performances, which would have given more accurate information and allow better test the hypotheses. However, using subjective measurement increased the response rate and allowed for comparing firms in different industries in this study.

Since the data for independent and dependent variables were collected from the same single respondent in the firm, common method variance and the potential common method bias might occur. We performed Harman's one-factor test to isolate artifactual covariance due to common method variance as a post-hoc remedy (Podsakoff and Organ, 1986). The results of Harman's single-factor analysis showed that there was more than one factor in the unrotated principal components factor analysis solution of all variables. Also, the first factor explained 34.88 percent of variance out of total 67.08 percent variance. Thus there is no substantial amount of common method variance in the study.

# CONCLUSION

The results of the study show importance and interdependency of the TQM practices to become successful in the TQM implementation. This study has found the TQM practices are statistically significantly and positively related to employee performance, innovation performance, and firm performance. The findings of the study support the continuance of the effective TQM efforts in a firm to improve performance, competitiveness, and survival in the market.

# ACKNOWLEDGEMENT

The retained measurement items can be given on demand by contacting the corresponding author.

# REFERENCES

*Ahire, S.L., Dreyfus, P., 2000. The impact of design management and process management on quality: an empirical examination. Journal of Operations Management 18, 549-575.*

Anderson, J.C., Rungtusanatham, M., Schroeder, R.G., 1994. A theory of quality management underlying the Deming management method. Academy of Management Review 9 (3), 472-509.

Asher, H.B., 1983. Causal modeling, Sage Publications, Beverly Hills, CA.

Bagozzi, R.P., Yi, Y., 1988. On the evaluation of structural equation models.

Bagozzi, R.P., Yi, Y., Phillips, L.W., 1991. Assessing construct validity in organizational research. Administrative Science Quarterly 36, 421-458.

Benson, P.G., Saraph, J.V., Schroeder, R.G., (1991). The effects of organizational context on quality management: an empirical investigation, Management Science, 37(9), pp. 1107-1124.

Besterfield, D.H., Besterfield-Michna, C., Besterfield, G.H, and Besterfield-Sacre, M., (2003). Total quality management. Third Edition. Prentice Hall, New Jersey.

Black, S. and Porter, L.J., (1995), An empirical model for total quality management, Total quality Management, 6 (2), pp. 149-164.

Brah, S.A., Tee, S.L., Rao, B.M., 2002. Relationship between TQM and performance of Singapore companies. International Journal of Quality and Reliability Management 19 (4), 356-379.

Chong, V.K., Rundus, M.J., 2004. Total quality management, market competition and organizational performance. The British Accounting Review 36, 155-172.

Claver, E., Tari, J.J., Molina, J.F., 2003. Critical factors and results of quality management: an empirical study. Total Quality Management 14 (1), 91-118.

Conca, J.F., Llopis, J., Tari, J.J., 2004. Development of a measure to assess quality management in certified firms. European Journal of Operational Research 156 (3), 683-697.

Corbett, L.M., Adam, Jr.E.E., Harrison, N.J., Lee, T.S., Rho, B.H., Samson, D., 1998. A study of quality management practices and performance in Asia and the South Pacific. International Journal of Production Research 36(9), 2597-2607.

Costa, M.M., Lorente, A.R.M., 2008. Does quality management foster or hinder innovation? An empirical study of Spanish companies. Total Quality Management 19 (3), 209-221.

Cronbach, L.J., 1951. Coefficient alpha and the internal structure of tests. Psychometrika 16, 297-334.

Cua, K.O., McKone, K.E., Schoreder, R.G., 2001. Relationship between implementation of TQM, JIT and TPM and manufacturing performance. Journal of Operations Management 19, 675-694.

Das, A., Handfield, R.B., Calantone, R.J., Ghosh, S., 2000. A contingent view of quality management-the impact of international competition on quality. Decision Sciences 31, 649-690.

Dean, J.W., Bowen, D.E., 1994. Management theory and total quality: improving research and practice through theory development. Academy of Management Review 19 (3), 392-418.

Deming, W.E., 1986. Out of crisis, Massachusetts Institute of Technology: Center for Advanced Engineering Study, Cambridge, Mass., Massachusetts Institute of Technology.

Douglas, T.J., Judge Jr., W.Q., 2001. Total quality management implementation and competitive advantage: the role of structural control and exploration. Academy of Management Journal 44, 158-169.

European Foundation for Quality Management, 2008. The fundamental concepts of excellence. http://www.efqm.org.

Feng, J., Prajogo, D.I., Tan, K. C., Sohal, A.S., 2006. The impact of TQM practices on performance a comparative study between Australian and Singaporean organizations. European Journal of Innovation Management 9 (3), 269-278.

Flynn, B.B., Schroeder, R.G., Sakakibara, S., 1994. A framework for quality management research and an associated measurement instrument. Journal of Operations Management 11 (4), 339-366.

Flynn, B.B., Schroeder, R.G., Sakakibara, S., 1995. The impact of quality management practices on performance and competitive advantage. Decision Sciences 26 (5), 659-691.

Fornell, C., Larcker, D.F., 1981. Evaluating structural equation models with unobservable variables and measurement error. Journal of Marketing Research 18 (1), 39-51.

Forza, C., Flippini, R., 1998. TQM impact on quality conformance and customer satisfaction: a causal model. International Journal of Production Economics 55, 1-20.

Fuentes, M.M.F., Saez, A.C.A., Montes, F.J.L., 2004. The impact of environmental characteristics on TQM principles and organizational performance. Omega 32 (6), 425-442.

Fuentes, M.M.F., Montes, F.J.L., Fernandez, L.M.M., 2006. Total quality management, strategic orientation and organizational performance: the case of Spanish companies. Total Quality Management 17 (3), 303-323.

Gluckman, P., Roome, D.R., 1993. Everyday heroes of the quality movement: from Taylor to Deming-the journey to higher productivity, second ed. Dorset House Publishing, New York, NY.

Goetsch, D.L., Davis, S.B., 2006. Quality management: introduction to total quality management for production, processing, and services, fifth ed. Prentice Hall, New Jersey.

Hackman, J.R., Wageman, R., 1995. Total quality management: empirical, conceptual and practical issues. Administrative Science Quarterly 40 (2), 309-342.

Ho, D.C.K., Duffy, V.G., Shih, H.M., 1999. An empirical analysis of effective TQM implementation in the Hong Kong electronics manufacturing industry. Human Factors and Ergonomics in Manufacturing 9(1), 1-25.

Hung, H.-M., 2007. Influence of the environment on innovation performance of TQM. Total Quality Management 18 (7), 715-730.

Irani, Z., Beskese, A., Love, P.E.D., 2004. Total quality management and corporate culture: constructs of organizational excellence. Technovation 24, 643-650.

Johston, C.G., Daniel, M.J., 1991. Customer satisfaction through quality. Canadian Business Review 18 (4), 12-15.

Kannan, V.R., Tan, K.C., 2005. Just in time, total quality management, and supply chain management: understanding their linkages and impact on business performance. Omega 33 (2), 153-162.

Kaynak, H., 2003. The relationship between total quality management practices and their effects on firm performance. Journal of Operational Management 21, 405-435.

Kaynak, H., Hartley, J.L., 2008. A replication and extension of quality management into the supply chain. Journal of Operations Management 26, 468-489.

Madu, C.N., Kuei, C.H., 1993. Introducing strategic quality management. Long Range Planning 26 (6), 121-130.

McAdam, R., Bannister, A., 2001. Business performance measurement and change management within a TQM framework. International Journal of Operations and Production Management 21 (1/2), 88-107.

Mohrman, S.A., Tenkasi, R.V., Lawler III, E.E., Ledford Jr., G.G., 1995. Total quality management: practice and outcomes in the largest US firms. Employee Relations 17 (3), 26-41.

Montgomery, D.C., 2005, Introduction to statistical quality control, fifth ed. John Wiley & Sons, New Jersey, USA.

Nair, A., 2006. Meta-analysis of the relationship between quality management practices and firm performance–implications for quality management theory development. Journal of Operations Management 24 (6), 948-975.

National Institute of Standards and Technology, 2006. Criteria for performance excellence. Baldrige National Quality Program http://www.quality.nist.gov/Business_Criteria.htm, 43-44.

Noe, R.A., Hollenbeck, J.R., Gerhart, B.,Wright, P.M., 2000. Human resource Management, third ed., McGraw-Hill, New York, NY.

Podsakoff, P.M., Organ, D.W., 1986. Self-reports in organizational research: problems and prospects. Journal of Management 12 (4), 531-544.

Prajogo, D.I., Sohal, A.S., 2001. TQM and innovation: a literature review and research framework. Technovation 21, 539-558.

Prajogo, D.I., Sohal, A.S., 2003. The relationship between TQM practices, quality performance, and innovation performance: an empirical examination. International Journal of Quality & Reliability Management 20 (8), 901-918.

Prajogo, D.I., Sohal. A.S., 2004. The multidimensionality of TQM practices in determining quality and innovation performance-an empirical examination. Technovation 24, 443-453.

Prajogo, D.I., Sohal, A.S., 2006. The integration of TQM and technology /R&D management in determining quality and innovation performance. Omega 34, 296-312.

Pun, K.-F., 2002. Development of an integrated total quality management and performance measurement system for self-assessment: A method. Total Quality Management. 13 (6), 759-777.

Rahman, S., Bullock, P., 2005. Soft TQM, hard TQM, and organizational performance relationships: an empirical investigation. Omega 33, 73-83.

Rungtusanatham, M., Forza, C., Filippini, R., Anderson, J.C., 1998. A replication study of a theory of quality management underlying the Deming method: insights from an Italian context. Journal of Operations Management 7, 77-95.

Sadikoglu, E., 2004. Total quality management: context and performance. The Journal of American Academy of Business, Cambridge 5 (1-2), 364-366.

Sadikoglu, E., 2008. Total quality management practices and performance. The Business Review, Cambridge 10 (2), 60-68.

Saraph, J.V., Benson, P.G., Schroeder, R.G., 1989. An instrument for measuring the critical factors of quality management. Decision Sciences 20, 810-829.

Sila, I., 2007. Examining the effects of contextual factors on TQM and performance through the lens of organizational theories: An empirical study. Journal of Operations Management 25, 83-109.

Sila, I., Ebrahimpour, M., 2003. Examination and comparison of the critical factors of quality management (TQM) across countries. International Journal of Production Research 41 (2), 235-268.

Stashevsky, S., Elizur, D., 2000. The effect of quality management and participation in decision-making on individual performance. Journal of Quality Management 5, 53-65.

Stevenson, W.J., 1996. Production/operations management, fifth ed. Irwin, Chicago, Ill.

Taylor, W.A., Wright, G.H., 2003. A longitudinal study of TMQ implementation: factors influencing success and failure. Omega 31 (2), 97-111.

Wali, A.A, Deshmukh, S.G., Gupta, A.D., 2003. Critical success factors of TQM: a select study of Indian organizations. Production Planning & Control 14(1), 3-14.

Walton, M., 1986. The Deming management method, Dodd Mead, New York, NY.

Weirauch, W., 2006. Can process management programs actually discourage innovation?
Hydrocarbon Processing 85 (1), 22-24.

York, K.M., Miree. C.E., 2004. Causation or covariation: an empirical re-examination of the link between TQM and financial performance. Journal of Operations Management 22, 291-311.

# THE RELATIONSHIP BETWEEN BUSINESS PROCESS REENGINEERING AND THE PERFORMANCE MEASUREMENT SYSTEMS : AN EMPIRICAL STUDY IN TURKEY

**Erkut ALTINDAG**
**Haluk TANRIVERDI**
**Cemal ZEHIR**

**Gebze Institue of Technology, Turkey**

## ABSTRACT

*In the global trade world, companies started to be transformed into a more flexible structure by reconstructing to adopt rapidly changing environment status. From the beginning of 1990's, companies have been needing radical changes on organizational structures includes its process methods. Companies need more flexible and faster organization structures to respond effectively to the customers's growing various types needs. This new concept as mentioned Reengineering is getting a good alternative for the companies. It's about the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical contemporary. In this empirical study, it's tried to specify the role of performance measurement in the reengineering process. The main object of this paper is evaluating current performance measurement system's affect to the role of performance measurement, empowerment, integration and long-term strategic alignment which are the tools of reengineering. These elements are presented with positive ways statistics. With the assistance of found symptons, the result of research are discussed and many suggestions are presented for both managers and academicians.*

## INTRODUCTION

The process of implementing Business Process Reengineering (BPR) is also often incomplete and fragmented in past literature. The solution to this problem might be achieved in two steps. The first step can be considered from two aspects. First, to achieve substantive reengineering performance, a business process should be first analyzed by certain characteristics from a high-level perspective (Teng et al., 1996).

Hammer and Champy (1993) noticed that the commonalities between companies that have chosen radical change to improve performance and those companies that succeed in achieving dramatic results.

This paper will argue some of the main concepts in business process reengineering with the goal of investigating their association with performance measurement systems. First, some of the main terms will be discussed and explained. Then, the research objectives will be stated followed by the research methodology and hypotheses, the result and conclusions will be given.

## BUSINESS PROCESS REENGINEERING

Business process reengineering is also known as BPR, Business Process Redesign, Business Transformation, or Business Process Change Management. Business process reengineering is one approach for redesigning the way work is done to better support the organization's mission and reduce costs. The most successful business book of the last decade, Reengineering the Corporation is the pioneering work on the most important topic in business today: achieving performance improvements (Hammer and Champy, 1993,).

Reengineering is a powerful change approach that can bring about radical improvements in business processes. However, the popular management literature has created more myth than practical methodology regarding reengineering. It has relied more heavily on hype than on research, common sense, or lessons of the past. In this paper, we attempt to "demythologize" some key aspects of reengineering by describing what we have observed in our research and practice. Seven reengineering myths are identified, discussed, and dispelled. By separating rhetoric from reality, we hope to help others to have reasonable expectations for success with their reengineering initiatives (Davenport and Stoddard, 1994).

Reengineering is also known as Business Process Reengineering. Hammer and Champy (1993) define BPR as “the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical contemporary measures of performance, such as cost, quality, service, and speed." Johansson *et al.* (1993) provide a description of BPR relative to other process-oriented views, "Business Process Reengineering, although a close relative, seeks radical rather than merely continuous improvement. It escalates the efforts of JIT and TQM to make process orientation a strategic tool and a core competence of the organization. BPR concentrates on core business processes, and uses the specific techniques within the JIT and TQM ”toolboxes” as enablers, while broadening the process vision."

Andrews & Stalick highlight the importance of the organisational integration aspects of BPR,defining it as: "radically changing how people work - changing business policies and controls, systems and technology, organizational relationships and business practices, and reward programs"(Andrews & Stalick, 1994).

Reengineering means to be disregarded all the assumptions and traditions of the way business has always been done, and instead develop a new, process-centere business organization that achieves a quantum leap forward in performance. To achieve reengineering success, a fresh perspective and approach is required. A clean sheet of paper is taken and, given what is currently known about customers and their preferences, a new organization is developed which will optimize the process of creating satisfied customers. Reengineering is the process by which the organization that exists today is retired and the optimal version of the new organisation is constructed. Reengineering is the opportunity to develop the rules by which business in the future will be conducted rather than being forced to operate by the rules imposed by someone else. As such, reengineering underpins every attempt to seize and maintain a true competitive advantage (Hammer and Champy, 1993).
There are many other definitons, which are variations of the above, emphasizing, different aspects of BPR depending on the application and need (Kuwaiti and Kay, 2000).
Reengineering initiatives typically lead to a business organization with these characteristics:
- Business processes are simplified rather than being made more complex.
- Job descriptions expand and become multi-dimensional – people perform a broader range of tasks.
- People within the organization become empowered as opposed to being controlled.
- The emphasis moves away from the individual and towards the team’s achievements.
- The organizational structure is transformed from a hierarchy to a flatter arrangement.
- Professionals become the key focus points for the organization, not the managers.
- The organization becomes aligned with the end-to-end process rather than departments.
- The basis for measurement of performance moves away from activity towards results.
- The role and purpose of the manager changes from supervisor to coach.
- People no longer worry about pleasing the boss. They focus instead on pleasing the customer.
- The organization’s value system transforms being protective to being productive.[2]

All of these definitions clearly recognize that the measurement of performance plays a very important role in the design and implementation of business process reengineering (Kuwaiti and Kay, 2000)

# PERFORMANCE MEASUREMENT SYSTEMS

Performance measurement systems is the auditor who in the last decade has increasingly focused on the outputs of management accounting systems. This focus has arisen due to audit practitioners and standard setters advocating that the auditor obtain a more in-depth understanding of client business to better aid in risk assessments and audit planning judgments. Hence, audit practitioners have turned to strategic management, especially strategic analysis, for more formal means of understanding the client’s business. Strategic management research emphasizes the use of performance measures to determine how successful management is in implementing its strategy, hence leading the auditor to focus on the client’s performance measurement system (Salterio et al, 2005).

Measuring performance in the manufacturing sector, has been dominated by ourdated costing systems and financial reporting that is required by the legislature and the stakeholders (Maskell, 1991). Employing a balanced scorecard as our performance measurement system given its emphasis in the management accounting literature and its use by audit firms as a training tool. We predict and find evidence consistent with auditors provided with a more extensive strategic analysis employ a broader set of performance measures in making their risk judgments than auditors provided with a less extensive strategic analysis. We also contribute by providing evidence about how differential strategic analysis extensiveness may result in different interpretations of the same outputs from a performance measurement system. (Salterio et al, 2005). Performance measurement systems has to balance a number of dimensions and to play a number of important roles to active business process reengineering to achieve success of whole system (Kuwaiti and Kay, 2000).

# EMPOWERMENT

Empowerment refers to increasing the spiritual, political, social or economic strength of individuals and communities. It often involves the empowered developing confidence in their own capacities. Managers indicated a desire to get work done while using less authority; that is, they desire to successfully ''empower'' employees (Bass et al., 1979). Defining the concept, ''to empower'' means to enable, to allow or to permit, and can be conceived as both self-initiated and initiated by others. Empowerment is the process of enabling workers to set their own work-related goals, make decisions and solve problems within their spheres of responsibility and authority (Litrell, 2006).

For many in Extension, empowerment is the goal we have for our programs and the volunteers, participants, or clients with whom we work. At the core of the concept of empowerment is the idea of power. The possibility of empowerment depends on two things. First, empowerment requires that power can change. If power cannot change, if it is inherent in positions or people, then empowerment is not possible, nor is empowerment conceivable in any meaningful way. In other words, if power can change, then empowerment is possible. Second, the concept of empowerment depends upon the idea that power can expand. This second point reflects our common experiences of power rather than how we think about power (Page and Czuba, 1999). Power is often related to our ability to make others do what we want, regardless of their own wishes or interests (Weber, 1946). Traditional social science emphasizes power as influence and control, often treating power as a commodity or structure divorced from human action (Lips, 1991). Conceived in this way, power can be viewed as unchanging or unchangeable. Weber (1946) gives us a key word beyond this limitation by recognizing that power exists within the context of a relationship between people or things. Power does not exist in isolation nor is it inherent in individuals. By implication, since power is created in relationships, power and power relationships can change. Empowerment as a process of change, then, becomes a meaningful concept.

Empowerment is a construct shared by many disciplines and arenas: community development, psychology, education, economics, and studies of social movements and organizations, among others. How empowerment is understood varies among these perspectives. In recent empowerment literature, the meaning of the term empowerment is often assumed rather than explained or defined. Rappoport (1984) has noted that it is easy to define empowerment by its absence but difficult to define in action as it takes on different forms in different people and contexts. Even defining the concept is subject to debate. Zimmerman (1984) has stated that asserting a single definition of empowerment may make attempts to achieve it formulaic or prescription-like, contradicting the very concept of empowerment. A common understanding of empowerment is necessary, however, to allow us to know empowerment when we see it in people with whom we are working, and for program evaluation. According to Bailey (1992), how we precisely define empowerment within our projects and programs will depend upon the specific people and context involved.

It's suggested that three components of our definition are basic to any understanding of empowerment. Empowerment is multi-dimensional, social, and a process. It is multi-dimensional in that it occurs within sociological, psychological, economic, and other dimensions. Empowerment also occurs at various levels, such as individual, group, and community. Empowerment, by definition, is a social process, since it occurs in relationship to others. Empowerment is a process that is similar to a path or journey, one that develops as we work through it. Other aspects of empowerment may vary according to the specific context and people involved, but these remain constant. In addition, one important implication of this definition of empowerment is that the individual and community are fundamentally connected (Page and Czuba, 1999).

# INTEGRATION

Integration is the degree to which an individual manager's action ise harmonious and consistent with the other departments, so that the combined action is contributing to the added value to the customer and enhancing the overall performance (Kuwaiti and Kay, 2000).

Many factors can influenc the extent of this integration. The literature identified many such mechanisms. Among the most important are shared vision, culture, goal setting and strategy formulation. Vision is to be realized, it needs to be converted into a process involving the planning and evaluation of performance. Both of these management systems rely on performance information (Sink and Tuttle, 1989; Kaplan and Norton, 1996a; 1996b) Culture has been identified as another integrating mechanism. It needs to be modified and adapted to reflect organizational context (Kotter and Heskett, 1992).

Today, the companies that has a competitive advantage can use the human resources power and its integration to long term strategy formulation (Çelik, 1993).

Integration is an important element in the philosophy. It seeks to weld the organization into a coherent and harmonious entity (Kuwaiti and Kay, 2000).

# METHOD

## Proposed Model and Research Hypotheses

The conceptual basis of this study for the hypotheses are shown in Fig.2. This framework includes five important variables. The conclusion of the study again pointed to the need for organizations to rethink the way work is being done, and to redesign the processes to achieve order of magnitude in a number of measures (Hammer and Champy, 1993).

## Sample Characteristics

All hypotheses were tested using 71 small and medium sized manufacturing companies from different industries located throughout Istanbul and Gebze area. The respondents were the chiefs and department managers. All responses from more individuals within the company would have given a more complete picture of the firm's situation and behaviour. Excluding cases with missing data, the final sample had 200 usable questionnaires. These questionnaries collected using mail surveys or face to face interviews.
The questionnaire included five different instruments to measure the five variables. Respondents were required to respond to each the five groups of questionnaire.

## Measures

All scales are adopted from previous literature (Kuwaiti and Kay, 1997) . The first of these variables is the effects of existing performance measurement system. The instrument used a modified version of the one developed by Dixon et al (1990). The scale used is from 1 to , where 1 indicates low importance or emphasis and 5 denotes high emphasis (Kuwaiti and Kay, 1997). This instrument has 11 statements.
An instrument designed by Hayes (1994), was used to measure the construct of empowerment. This instruments consists 14 statements. At the analyse process, four of them has eliminated. Respondents were asked to rate the extent to which they agree with each of the statements on a scale from 1 (disagree) to 5 (agree).
The third variable, integration; is a construct that is represented by 20 statements. Its extent is like empowerment instrument; except reverse scaled. In the analyses of "long term strategic alignment" instrument 11 statements has used. Respondents were asked to rate their willings with each statement on a scale from 1 to 5, where 1 denotes not important and 5 very important. The last variable is perceived success of performance measurement. Totally 23 statements are represented to respondents about management's authority (Kuwaiti and Kay, 1997). The scale is from 1 (prohibitive) to 5 (supportive). Dependent and independent variables will be discussed below.

## Measure Validation and Factor Analyses

Every variable is evaluated separately in factor analyse. These are effect of Existing performance measurement system (11 items), Perceived success of performance measurement (23 items) , Empowerment (10 items), Integration (18 items), Long term strategic alignment (11 items). The results of factor analyses show that all variables are part of a entirety in this research.
Coefficient alpha estimates (Cronbach's Alpha = .84; .78; .87; .85; .89, respectively, perceived success of performance measurement, empowerment, integration, long term strategic alignment and existing performance measurement system) show that measurement scales used in this empirical study are applicable reliable.

## TESTED HYPOTHESIS, TABLES AND FIGURES

***Figure 1. Reengineering process***

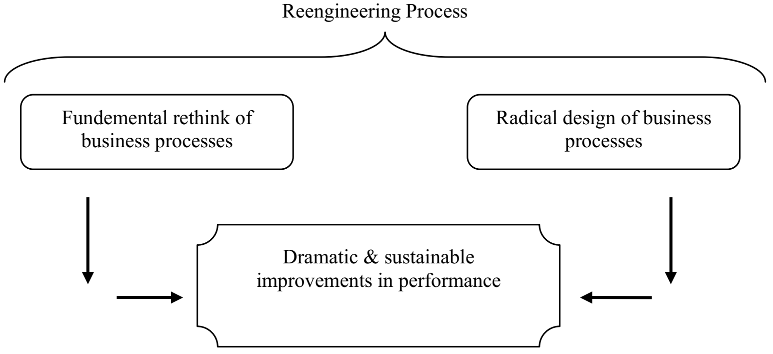



***Fig.2 : :Hypothesized model.***

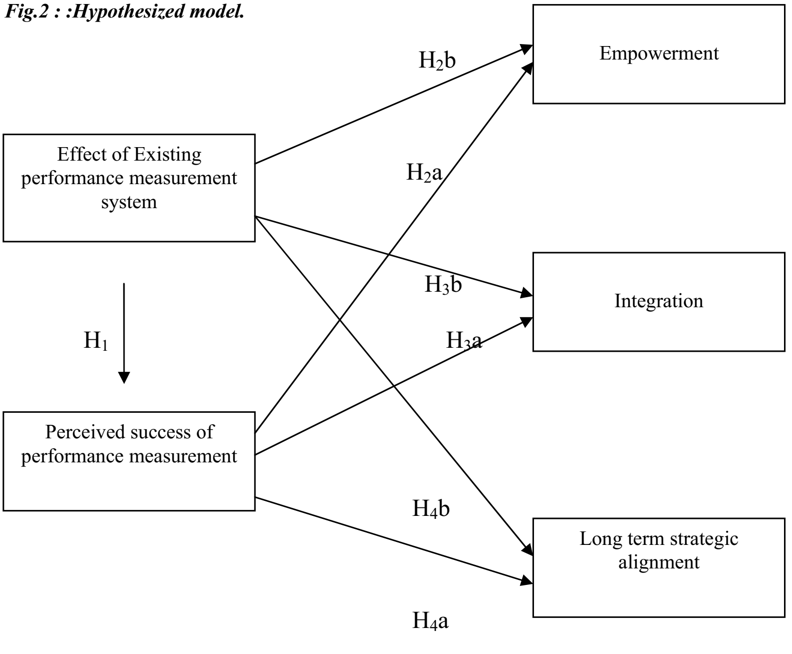


*Table 1 . Sample Characteristics*

| Position | Number | Percentage (%) |
|---|---|---|
| Chief / Senior Chief | 118 | 59 |
| Middle Level / Department Manager | 82 | 41 |
| TOTAL | 200 | 100 |

*Table 2 . Output of Reliability Analysis*

| VARIABLES | Number of Question | Coefficient Alpha |
|---|---|---|
| 1- Effect of existing performance measurement system | 11 | 0,89 |
| 2- Perceived success of performance measurement | 23 | 0,84 |
| 3- Empowerment | 10 | 0,78 |
| 4- Integration | 18 | 0,87 |
| 5- Long term strategic alignment | 11 | 0,85 |

**Table 3. Effects of existing performance measurement system on perceived success of performance measurement.**

| | Standardized β | Sign | Result |
|---|---|---|---|
| Effects of existing performance measurement system | 0,617 | 0,000 | **Accepted** |
| **F**=171,736 **$R^2$=** 0,464 | | | |

**$H_1$ :** A positive and significant relationship between effect of existing performance measurement system and perceived success of performance measurement.

The regression analysis result for the effects of existing performance measurement system on perceived success of performance measurement indicate that there is a positive and significant relationship between two variables. Any changes about Effects of existing performance measurement system may reflect on perceived success of performance measurement process.

**Table 4. Effects of existing performance measurement system and perceived success of performance measurement on empowerment**

| | Standardized β | Sign | Result |
|---|---|---|---|
| perceived success of performance measurement | 0,184 | 0,052 | **Rejected** |
| effect of existing performance measurement system | 0,224 | 0,009 | **Accepted** |
| **F=** 16,595 **$R^2$=** 0,144 | | | |

**$H_2$a :**There is a positive and significant relationship between perceived success of performance measurement and empowerment.
**$H_2$b :** There is a positive and significant relationship between effect of existing performance measurement system and empowerment.

In the regression analysis conducted for examining effects of existing performance measurement system and perceived success of performance measurement on empowerment, the result show that effects of existing performance measurement system has a positive effect on empowerment but the positive effect of perceived success of performance measurement on empowerment is not supported.

**Table 5. Effects of existing performance measurement system and perceived success of performance measurement on integration**

| | Standardized β | **Sign** | **Result** |
|---|---|---|---|
| perceived success of performance measurement | 0,182 | 0,120 | **Rejected** |
| effect of existing performance measurement system | 0,406 | 0,000 | **Accepted** |
| **F**= 23,779 **$R^2$**= 0,194 | | | |

**$H_3$a :** There is a positive and significant relationship between perceived success of performance measurement and integration.
**$H_3$b :** There is a positive and significant relationship between effect of existing performance measurement system and integration.

The regression analysis results for impacts of the effects of existing performance measurement system on integration have positive effects on integration variable. It is hard to say that same explanation can be used for the effect of perceived success of performance measurement on integration.

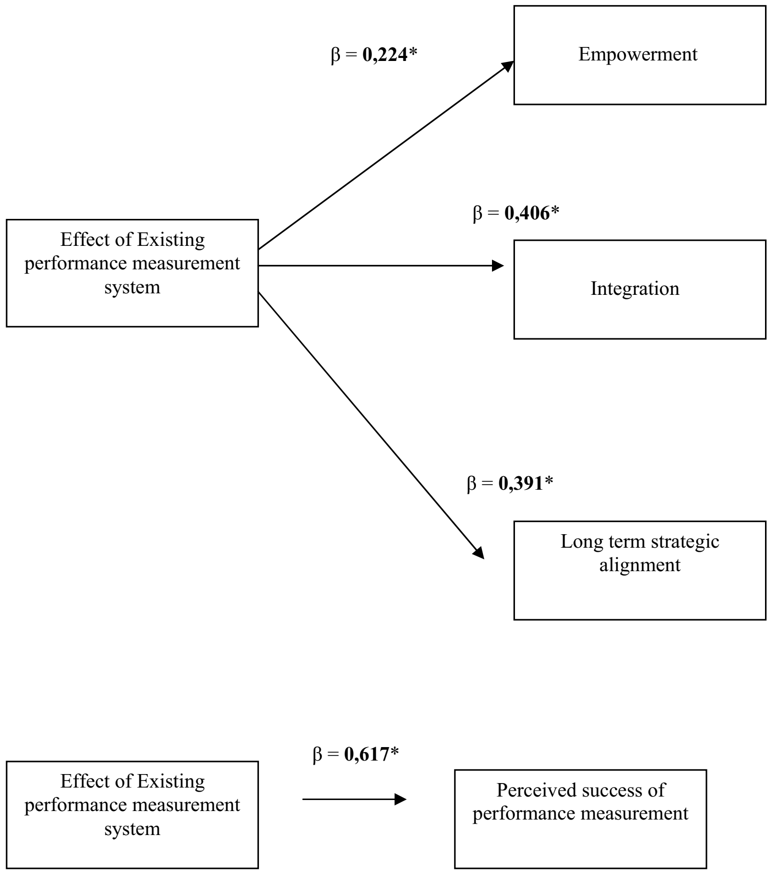
**Table 6. Effects of existing performance measurement system and perceived success of performance measurement on logn term strategic alignment**

| | Standardized β | **Sign** | **Result** |
|---|---|---|---|
| perceived success of performance measurement | 7,602 | 0,287 | **Rejected** |
| effect of existing performance measurement system | 0,391 | 0,000 | **Accepted** |
| **F**= 43,620 **$R^2$**= 0,307 | | | |

**$H_4$a :** There is a positive and significant relationship between perceived success of performance measurement and long term strategic alignment.
**$H_4$b :** There is a positive and significant relationship between effect of existing performance measurement system and long term strategic alignment.

In the last regression analysis; hypothesis about a positive and significant relationship between effect of existing performance measurement system and long term strategic alignment is accepted.

*Fig. 3 : Results of the hypotheses tests*




** Significant at 0.01 level

* Significant at 0.05 level

# DISCUSSION

## Limitations and future research directions

This article has several limitations that should be kept in mind. The extension of the proposed model to other firms would improve study's overall generalizability. Caution should be taken when generalizing the results to all organizations other than manufacturing firms. Another potential limitation concerns the multidimensional nature of firm performance. Dealing with the various components of firm performance always presents a challenging set of problems for researchers. National culture, traditions and economic conditions may influence empowerment and long term strategic alingment, which has implications for the generalizability of study's findings.

## Conclusion

In this article, we have focused on the effect of performance measurement systems on business performance and some organization's characteristics like empowerment, integration and long term strategic alignment. Performance measurement systems have to provide a fast feedback to analyse firm's performance measurements truthfully.

Managers must make contract with successful workers and make them adapted to the business. Empowered employess takes more risk and join strategic alliences more than usual. During the business process reengineering activity, firm's vision, mission and strategic plan must be upgraded. The subfactors to achieve are empowerment and integration of all systems. Organizations wishing to excel in today's global economy are expecting positive organizational outcomes based on empowered employee's leadership behavior styles (Wegner, 2004).

In conclusion, this study reveals that manufacturing firms can also increase organizational performance by employing business process reengineering. While maintaining economies of scale, business reengineering can help companies develop personalized products and services (Tai, Huang, 2007). During the business process reengineering, managers must emphasis on empowerment to develop their employee's skills, connects all layer and department smoothly and make new raliable strategic plans through firm's vision. Business reengineering provides a way for manufacturers to effectively respond to the challange of changing environments. Briefly, performance measurement systems on business process reengineering operations have become increasingly more commonplace and therefore, require careful empirical analysis to improve our understanding of the outputs of these field researchs.

# REFERENCES


Andrews, D. A. & Stalick, S. K. (1994), *Business Reengineering: The Survival Guide*, Englewood Cliffs, NJ: Prentice-Hall

Bailey, D. (1992). Using participatory research in community consortia development and evaluation: lessons from the beginning of a story. American Sociologist, 23 (4), 71-82.

Bass, B. M., Burger, P. C., Doktor, R., & Barrett, G. V. (1979). Assessment of managers: An international Comparison. New York: Free Press.

Çelik, C. (1993). "Kalite Yönetiminde İnsan Faktörü", "Verimlilik Dergisi", MPM Publish, Special Edition (In Turkish)

Davenport, T.H., Stoddard, D.B., (1994), Reengineering: Business Change of Mythic Proportions?, MIS Quarterly*,* Vol. 18, No. 2, 121-127.

Dıxon, J.R. Ve Arnold, P. ( 1994) "Business Process Reengineering: Improving in New Strategic Directions", California Management Review

Hammer, M., Ve Champy, J. (1993). "Reengineering the coorparation"

Hayes, B. (1996) "How to Measure Empowerment," Quality Progress, February, Vol.27, No:2,

Johansson, H., McHugh, P., Pendlebury, J. and Wheeler, W. (1993), Business Process Reengineering: Break Point Strategies for Market Dominance, John Wiley and Sons, Chichester.

Kaplan, R., Norton, D. (1996) "Using the balanced scorecard as a strategic management system", Harvard Business Review, January/February

Kotter J.P., Heskett J.L., (1992). Corporate culture and performance, Maxwell Macmillan Canada

Kuwaiti, M.E. ve Kay, J. M., "The role of performance measurement in business process re-engineering", International Journal of Operations & Produciton Management, Vol.20, No:12, 2000.

Lips, H. (1991). Women, men and power. Mountain View, CA: Mayfeld.

Littrell R.F., (2007; 87-110), Influences on employee preferences for empowerment practices by the ''ideal manager'' in China, International Journal of Intercultural Relations

Maskell, B.H., (1991), Brian Performance measurement for world class manufacturing : a model for American companies, Productivity Press

Page, N, Czuba C. E. (1999) Empowerment: What Is It?, Empowerment: What Is It?, Volume 37 Number 5

Rapport, J. (1984). Studies in empowerment: Introduction to the issue. Prevention in Human Services, 3, 1-7.

Salterio S., W.R. Knechel, N. Kotchetova (July, 2005). Performance Measurement Systems and Strategic Analysis Extensiveness: The Auditor's Usage of Balanced Scorecards and Performance Benchmarks AAA Management Accounting Section 2006 Meeting Paper

Sink, D.S., Tuttle, T.C., (1989; 989 – 999). Planning and measurement in your organization of the future, International Journal of Operations & Production Management, Volume: 18 Issue: 9/10

Tai, D. W-S., Huang, C-E., (2007; 296-301). The relationship between electronic business process reengineering and organizational performance in Taiwan, Journal of Academy of Business, Cambridge, Volume: 10, No: 2.

Teng, J.T.C., Grover, V, Fiedler, K.D. (1996). Developing strategic perspectives on business process reengineering from process reconfiguration to organization change, Omega International Journal of Management Science 24 (3), pp. 271-294.

United States General Accounting Office (1997), Business Process Reengineering Assessment Guide.

Weber, M. (1946). From Max Weber. H.H. Gerth & C.W. Mills (Eds.). New York: Oxford University Press.

Wegner, L.L., (2004). Organizational leaders and empowered employees: the relationship between leadership styles, perception of styles, and the impact on organizational outcomes, Capella University.

Zimmerman, M.A. (1984). Taking aim on empowerment research: On the distinction between individual and psychological conceptions. American Journal of Community Psychology, 18(1), 169-177.

# EFFECTS OF TOTAL QUALITY MANAGEMENT PRACTISES ON ORGANIZATIONAL PERFORMANCE OF HOSPITAL

**Cemal Zehir**
**Gebze Yüksek Teknoloji Enstitüsü**

**Özlem Aracı**
**İstanbul Teknik Üniversitesi**

**Mehtap Özşahin-Esin Sadıkoğlu**
**Gebze Yüksek Teknoloji Enstitüsü**

## ABSTRACT

*Growing importance of competitive advantage affects management of hospitals and it leads hospitals to be more effective. Because of this, hospitals create their strategies to have a competitive advantage. And total quality management (TQM) implementations in hospitals are widespread way to be more competitive.The aim of this paper is to investigate effects of TQM practises on operational, innovation and financial performance of hospital. Survey method is implemented. The data is gained from 138 usable questionnaire. Our respondents are nurses, doctors, head doctor and department managers of international hospital which is certified by JCI Accreditation and ISO9001:2000. Through the analysis procedure firstly reliability and validity tests are used. Then multiple regression analysis has been implemented. So our result shows that there is a positive and significant relationship between TQM practises on performance dimensions of hospital,except "continuous improvement". And which TQM practises have direct effect on variances of operational, innovation and financial performance of hospital is determined.*

***Key words:*** *total quality management practises, performance, hospital.*

## 1. INTRODUCTION

Competitive advantage is one of the most important outcome of a strategy. It gives chance to organizations for competition and sustainability. A growing number of organizations use total quality management (TQM) to generate a competitive advantage. There is a growing body of empirical research that investigates relationship between implementation of TQM and organization performance.

Support for the idea of customer-defined quality was first seen in the writing of such experts as Crosby (1979, 1985) and Juran (1989). Crosby referred to quality as conformance to requirements. Juran viewed quality as ''fitness for use.'' The common thread between each of these definitions is the idea that the consumer is the final authority on quality(Gowan et al., 2001, p.276).

The relationship between performance and TQM has been analyzed according to the degree of implementation of its elements (leadership, quality-oriented culture, reward system, employee participation, etc.). TQM is a really complex issue that can only be achieved by integrating several research topics that analyze human, managerial, technical and contextual aspects. The study of TQM effectiveness cannot be performed by only considering a single perspective since a firm's success does not depend on just one single factor (Fuentes-Fuentes et al., 2004, p.425-426).

Three principles of total quality are customer focus, continuous improvement, and teamwork, and most of what has been written about total quality is explicitly or implicitly based on these principles. Each principle is implemented through a set of practices, which are simply activities such as collecting customer information or analyzing processes(Dean, Bowen, 1994, p.394).

The aim of this study is examine the total quality management practices and organizational performance of hospitals in service industry. Evaluating organizational performance of service is more difficult than product. Services are intangible, uncountable and it is impossible to inventory and test. We focus on quality practices taken on organizational level such as; decision making, process management, continuous improvement, relations with suppliers, customer focus, system approach. Effects of these quality practices on financial, operational and innovation performance of hospital is examined. In our study firstly researches related with these quality practices are offered based on the review of the literature. Secondly research methodology, including analyses is described. And then results of analyses are presented. Finally discussion and conclusions are shared.

# 2.LITERATURE REVIEW

TQM has been described in the literature as a number of methods and tools which an organization can use an enterprise strategy with focus on continuous improvements and as a management philosophy. Although the complexity of quality and the TQM concept it is clear that a long-term focus on quality has become a competitive weapon (Wiklund, 1999, p.103). Fiegenbaum, Ishikawa, Taguchi, Crosby, Kearns, Mazda, Taylor, Deming, and Juran have made significant contributions to TQM (Rodger et al., 1999, p.253).

One recurrent theme within the literature on total quality management (TQM) is the study of its effect on organizational performance. Nonetheless, most research has focused on analyzing the relationships between the implementation of different elements and several types of performance. (Fuentes-Fuentes et al., 2004:425). There is a substantial body of empirical research that provides implementation of Total Quality Management (TQM) and relation with firm performance (for example; Easton & Jarrell, 1998; Lemak et al., 1997; Samson & Terziovski, 1999; Shetty, 1993).

Most empirical studies have found TQM to have positive effects on organizational performance (Mann & Kehoe, 1994; Wilkinson et al., 1994; Radovilsky et al., 1996). However, some studies have found considerably high failure rates in applying TQM (Harari, 1993). It can be concluded that when TQM is well implemented it can help an organization improve itself and, in the process, better serve its community and its own members (Stashevsky,Elizur, 2000:55)

Rad (2006:615) have shown that TQM had the most effects on process management, focus on customers and leadership and management. On the other hand, human resource problems, performance appraisal and strategic problems were the most important obstacles of TQM success respectively.

Kjos et al., (2008) indicated the methods and ideas behind Total Quality Management are used to improve systems of care and as a guide to analysing quality improvement in organizations . Total Quality Management can be divided into six components: ‘priority of quality’, ‘leader’s involvement’, ‘process orientation’, ‘measure of performance’, ‘employee participation’ and ‘customer focus’.

MBNQA (Malcolm Baldrige National Quality Award)consists of six criteria of organizational practices and one criterion of organizational performance. The TQM practices embodied in the six criteria of organizational practices are leadership, strategy and planning, customer focus, information and analysis, people management, and process management.

Reliability should be relatively more important to maintain and improve for services. Initial support for the importance of service reliability in the service quality literature comes from studies using the servqual survey methodology (Parasuraman et al., 1985). In their review of the servqual research, reliability is consistently the most important service quality dimension, or largest ‘‘gap,’’ to improve across service industries ( Nilsson et al., 2001:7).

Further, service encounters are complicated because differences in tangibility and human interaction lead to differences in quality control. The human element basically eliminates the ability of the organization to deliver a totally uniform product with zero deviation from standards, something that might be accomplished in a manufacturing firm (Gowan et al., 2001:277). Determining customer satisfaction for services is more important than product (Anderson et al., 1997). Because many services are personnel-intensive and customized to suit very heterogeneous needs, customization is more important for services than for manufactured goods (Nilsson et al., 2001:7).

The main difference in both a product and service environment is that service firms do not have any external contextual factors (such as entry barriers and degree of external quality demand) that influence quality practice, while this is evident for product firms( Nilsson et al., 2001:9).

Quality performance in health care departments can be measured using nine dimensions: appropriateness, continuity, effectiveness, efficacy, efficiency, timeliness, availability, respect and caring, and safety (Rodger et al., 1999:254).

Lemak and Reed (1997) investigate the impact of quality practice on performance in organizations that had been committed to quality management for a 5-year period. Their results indicate that a firm's market valuation increases significantly after its implementation of quality management. Rodger et al. (1999) indicates the quality performance construct comprises of appropriateness of services, availability of services, continuity of services, effectiveness of services, efficacy of procedures, efficiency of services, respect and caring for customers, timeliness of services, service tangibles, and customer safety.

In this research, leadership, process management, continuous improvement, workforce focus, relations with suppliers, customer focus, system approach, financial and operational performance and innovation performance is examined as quality practices.

# 3. TOTAL QUALITY MANAGEMENT PRACTISES

## 3.1.Decision Making

Puffer and McCarthy (1996) provide a framework for leadership in a TQM context and argue that top management's ability to create a vision and promote change is at the heart of successful TQM implementation. In other words, top management needs transformational leadership skills.

When purchasing services, fewer tangible cues exist. In most cases, tangible evidence is limited to the service provider's physical facilities, equipment, and personnel. Because of service intangibility, a firm may find it more difficult to make decision how consumers perceive services and service quality. When a service provider knows how the service will be evaluated by the consumer, we will be able to suggest how to influence these evaluations in a desired direction (Parasuraman et al., 1985:42).

For quality management to occur, managers must switch from their traditional administrative roles and become leaders who set goals and who steer the quality initiative in the right direction (Koumoutzis, 1994).So decisions can be more effective on operational performance.

## 3.2.Process Management

A process is a set of activities that, taken together, produce a result of value to a customer (Ittner ,Larcker, 1997). A process is therefore a structure for action, the structure by which an organization does what is necessary to produce value for its customers ( Nilsson et al., 2001:11). The core ideas behind this facet of TQ are that organizations are sets of interlinked processes, and that improvement of these processes is the foundation of performance improvement(Dean,Bowen, 1994:407) .

Service processes differ from their manufacturing counterparts because they involve complex and highly interactive transactions that must be delivered upon demand and in the presence of the customer. The presence of the human element at most or all stages of the service delivery process greatly increases the probability of error on the part of management, employees, and customers (Gowan et al., 2001, p.277). Unlike products, where assembly plant managers are likely to carefully map out process details and rigorously adhere to the process maps, services are not subject to the same process discipline resulting in greater variation in the process (Frei et al., 1999). Importantly, the production process is more visible to service customers than to product customers. Because the production process is visible to service customers — indeed they are part of the process — process orientation should have a significant direct impact on customer satisfaction with services (Nilsson et al., 2001, p.12-13).

When the customer is deeply involved in the service delivery process, such as in highly professional services, it becomes extremely difficult to maintain high levels of process control (Gowan et al., 2001, p.277).Reed et al. (1996:180) think concept of process improvement is considered the main tool for improving efficiency.

## 3.3.Continuous Improvement

Continuous improvement is sometimes seen as being equivalent to Kaizen—the never-ending attention to detail that reduces the effort and time that it takes to conduct operations(Reed et al., 1996:181).This is one of the core concepts of TQM based on a commitment to ongoing process revision,both technical and administrative, directed at continuously improving such processes (Fuentes-Fuentes et al., 2006,p:306).

Kaynak (2003:406) implies TQM can be defined as a holistic management philosophy that strives for continuous improvement in all functions of an organization, and it can be achieved only if the total quality concept is utilized from the acquisition of resources to customer service after the sale.

TQM is a managerial innovation that emphasizes an organization's total commitment to the customer and to continuous improvement of every process through the use of datadriven, problem-solving approaches based on empowerment of employee teams(Rodger et al., 1999:252).

## 3.4.Relations With Suppliers

The production of quality products is necessarily dependent on the timely delivery of quality materials, so it is essential that materials supplied meet the buyer's specifications and standards for quality (Flynn et al., 1995; Forza and Flippini, 1998; Trent and Monczka, 1999).

Kannan and Tan (2005:153) indicates effective management of the supply chain is viewed as the driver of reductions in lead times and material costs, and improvements in product quality and responsiveness. Krause et al., (1998:39)thinks if the supply chain is to be a source of competitive advantage, suppliers' performance must be managed and developed to meet the needs of the buying firms.

Managing the supply chain implies reducing and streamlining the supplier base to facilitate managing supplier relationships, developing strategic alliances with suppliers, working with suppliers to ensure that expectations are met, and involving suppliers early in the product development process to take advantage of their capabilities and expertise (Kannan, Tan, 2005:155).

## 3.5.Customer Focus

Customer defines quality and, in turn, that quality creates customer satisfaction which leads to an improved competitive position. Equally consistent is the view that the costs of waste and rework are high and should be eliminated (Reed et al., 2000:7)**.** A customer orientation emphasizes an organization's ability to attain customer information, analyze it to set priorities for improvement, and use these priorities to drive product and process change( Nilsson et al., 2001:11). Reed et al. (1996:180) indicated that with customer orientation, organizations will focus on gaining a market advantage where they can outperform their competitors in terms of attracting more customers with distinguished products and charge a premium price.

Dean and Bowen (1994:394) imply the first and most important principle is customer focus. The goal of satisfying customers is fundamental to total quality and is expressed by the organization's attempt to design and deliver products and services that fulfill customer needs.

Nilsson et al.,(2001:13)defend customer satisfaction to have a greater impact on business results for services versus products. satisfaction–performance logic depends on the regularity of the purchase–consumption–repurchase cycle. For many services, this is a regular and often-repeated cycle. Therefore, customer satisfaction has a larger direct impact on business results for services than for products**.**

Over the last few years, it has been seen that a firm's survival depends to a great extent on the capacity to constantly satisfy the customers' needs and to overcome competitive pressures(Fuentes-Fueantes et al., 2004:426).

## 3.6.System Approach

The typical TQM focus on the organization as a total system has a number of implications, including the involvement of the individual employee as a critical part of a problem solving team and a recognition that quality enhancement involves a fundamental cultural shift toward honestly assessing and responding to customer- driven concerns (Sıtkın et al.,1994:542). Ravichandran, Rai,(2000:386) suggest that all elements of the organizational system need to be developed in order to attain quality goals and piecemeal adoption of select quality management practisese are unlikely to be effective TQM as evolved as an approach to quality that is characterized as an integrated, systematic organization-wide strategy for improving product and service quality.

Benneth, Kerr, (1996:648) indicates that without applying systems thinking to such an implementation, it will be very difficult if not impossible for TQM to develop into a practical `generator' of evolutionary and revolutionary change within an organization.

It is required to integrate TQM into the organization's core values and the implementation process be approached from an integrated system viewpoint and not piecemeal. It is recommended the everyone in the organization be informed not only of the strategic direction but also of the current imperatives and current performance(Shin et al., 1998:12)

## 3.7.Financial Performance

Quality performance improves financial and market performance, and the literature offers several explanations for these effects. First, as a firm acquires a reputation for delivering high quality products and services, the elasticity of demand can decrease, which, in turn, can enable the firm to charge higher prices and earn higher profits. Second, improving product quality by reducing waste and improving efficiency will increase the return on assets which will increase profitability. Third, reduced rework, less scrap, and improved productivity will lower the cost structure of a firm, which enables the firm to offer lower prices. Low prices can increase market share and sales (Kaynak, 2003:418).

Measuring cost and benefits of a quality system will require expanding the management account ing system to include the measurement and reporting of life cycle costs, quality costs, and measures of continuous improvement.Life cycle and quality costs are important in tracking improvements, but cost data do not result directly in improved products or services (Ragothaman, Korte, 1999:61-62).

Alexander et al., (2006:1022) suggest that quality improvement in hospitals effectively can reasonably expect to improve their financial and cost performance, or at least not place the hospital at risk for investing in quality improvement. Hospitals operate on the assumption that improving clinical processes through quality improvement will improve financial performance by reducing variability in care process/inputs, thereby increasing efficiency, and by improving the competitive position of the hospital by improving the quality of the services provided and making the hospital more attractive to patients and payers.

## 3.8.Operational Performance

Parkan,Wu (1997:2963)define operational performance is a concept of how well a production unit makes use of its resources when converting them into outputs of goods and services.To compare the relative operational performance of product unit may involve activities that have resource consumption and value generation implications.
Samson, Terziovski (1999:393) explained the categories of leadership, management of people and customer focus were the strongest significant predictors of operational performance. This is consistent with literature findings that behavioural factors such as executive commitment, employee empowerment and an open culture can produce competitive advantage more strongly than TQM tools and techniques such as process improvement, benchmarking, and information and analysis.

## 3.9.Innovation Performance

Prajogo, Sohal, (2006:36) identified two competing arguments. The first argument suggests that TQM is positively related to innovation performance because it establishes a system and culture that will provide a fertile environment for organizations to innovate. The implication is that TQM needs to be complemented by other resources to more effectively realize the strategy in achieving a high level of performance, particularly innovation.

Martinez Costa,Martinez Lorente (2008:209) indicates TQM promotes innovation within companies is provided. There is also evidence that companies that apply TQM and companies that develop organizational innovation get more benefits than companies than do not. Continual improvement in TQM assumes that new concepts for maintaining innovation and quality will emerge to carry organizations into the next century and beyond.

Prajogo, Sohal (2006:306)demonstrates that TQMis strongly associated with technology and R&D which are the key antecedents of innovation performance and, therefore, it cannot be plausibly considered as impediment for innovation. More importantly, although quality management may not directly result in innovation, as noted earlier, organizations must have the capability to manage the quality before embarking on managing innovation.

Hung (2007:716) adopts a practical viewpoint that treats TQM as the process and innovation as the performance output of TQM, thereby arguing that in a suitable environment TQM can lead to innovation via business environment supports as well as quality performance.

# 4.RESEARCH METHODOLOGY

To give an overview effects of TQM practises on organizational performance of international private hospital in Turkey which is certificated by JCI Accreditation and ISO 9001:2000, our hypotheses are;

$H_1$: There is a positive relationship between TQM practises and operational performance.
$H_2$: There is a positive relationship between TQM practises and innovation performance.
$H_3$: There is a positive relationship between TQM practises and financial performance.

In this study survey method is implemented. 138 usable questionnaire have provided contribution to our analyses. The questionnaire is implemented to nurses, doctors, head doctor and department managers of hospital in order to map to effect of TQM practises on operational, innovation and financial performance of hospital by their perceptions. It includes 40 questions related with TQM practises and performance dimensions as in the research model (Figure 1). The questions has been developed by previous empirical researches and extensive literature review. Five point Likert-type scale (1-strongly disagree, 5-strongly agree) is used by respondents.

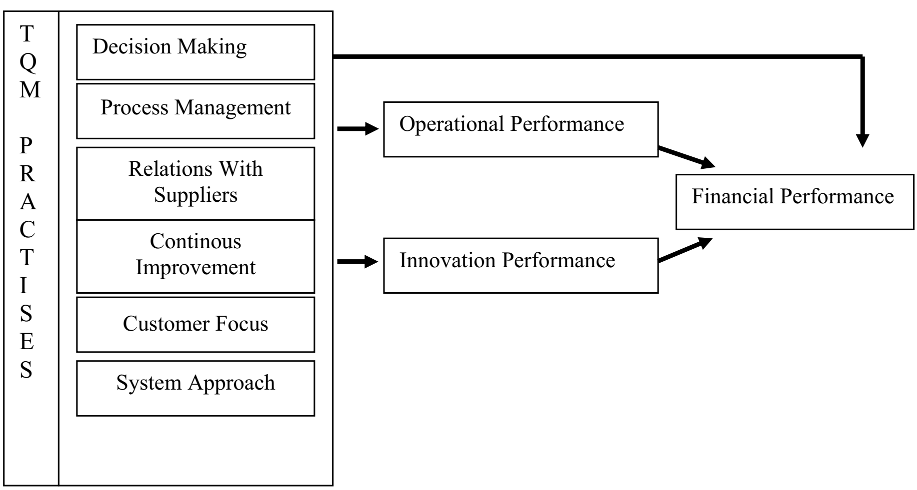



**FIGURE 1. RESEARCH MODEL**

Through the analysis procedure, firstly reliability and validity tests are used. Then multiple regression analysis has been implemented to examine the effect of TQM practises on performance dimensions of hospital.

The cronbach's alpha measure is a widely used reliability coefficient that inquires the internal consistency of the questions of each TQM practises and performance dimensions. Table 1 shows the descriptive statistics and cronbach's alpha values. The cronbach's alpha values are between .818 and .926. This result indicates a strong reliability of the questionnaire.

## TABLE 1.DESCRIPTIVE STATISTICS AND CRONBACH'S ALPHA VALUES OF THE TQM PRACTISES

| | Mean | Standard deviation | Cronbach's alpha |
|---|---|---|---|
| Decision making | 4.03 | 0.55 | 0.818 |
| Process management | 3.98 | 0.66 | 0.877 |
| Relations with suppliers | 3.81 | 0.61 | 0.881 |
| Continuous improvement | 3.00 | 1.01 | 0.916 |
| Customer focus | 4.27 | 0.57 | 0.912 |
| System approach | 4.16 | 0.61 | 0.862 |
| Operational performance | 3.79 | 0.65 | 0.926 |
| Innovation performance | 4.07 | 0.63 | 0.839 |
| Financial performance | 3.99 | 0.72 | 0.913 |

To evaluate homogeneity of the questions factor analysis plays an important role. Because factor analysis ensure that they are reliable indicators of TQM practises and performance dimensions. Table 2 shows factor loading values of each question. And all the values are enough high for reliability level of scale.

## TABLE 2. RESULTS OF FACTOR ANALYSIS

| | Factor Loading | Eigenvalues |
|---|---|---|
| Decision making | | 6.38% |
| 1 | 0.635 | |
| 2 | 0.567 | |
| 3 | 0.758 | |
| 4 | 0.719 | |
| Process management | | 7.57% |
| 1 | 0.740 | |
| 2 | 0.744 | |
| 3 | 0.714 | |
| 4 | 0.738 | |
| Relations with suppliers | | 9.05% |
| 1 | 0.706 | |
| 2 | 0.653 | |
| 3 | 0.738 | |
| 4 | 0.798 | |
| 5 | 0.711 | |
| Continuous improvement | | 5.18% |
| 1 | 0.940 | |
| 2 | 0.926 | |
| Customer focus | | 12.21% |
| 1 | 0.721 | |
| 2 | 0.781 | |
| 3 | 0.844 | |
| 4 | 0.784 | |
| 5 | 0.758 | |
| 6 | 0.587 | |

| | | |
|---|---|---|
| System approach | | 7.39% |
| 1 | 0.615 | |
| 2 | 0.724 | |
| 3 | 0.724 | |
| 4 | 0.671 | |
| Operational performance | | 15.51% |
| 1 | 0.714 | |
| 2 | 0.723 | |
| 3 | 0.748 | |
| 4 | 0.652 | |
| 5 | 0.788 | |
| 6 | 0.756 | |
| 7 | 0.804 | |
| 8 | 0.748 | |
| 9 | 0.707 | |
| 10 | 0.701 | |
| Innovation performance | | 5.93% |
| 1 | 0.712 | |
| 2 | 0.705 | |
| 3 | 0.739 | |
| Financial performance | | 5.32% |
| 1 | 0.837 | |
| 2 | 0.822 | |

**Multiple regression analysis of operational performance:**
To explore relationship among the TQM practises and operational performance of hospital, correlation values are showed in Table 3. Except "continuous improvement" other correlation values are positive and significant at the 0.01 level.

## TABLE 3. CORRELATION VALUES BETWEEN OPERATIONAL PERFORMANCE AND TQM PRACTISES

| | Operational Performance | |
|---|---|---|
| | r | p |
| Decision making | 0,399 | 0,001** |
| Process management | 0,335 | 0,001** |
| Continuous improvement | 0,029 | 0,739 |
| Tedarikçilerle ilişkiler | 0,482 | 0,001** |
| Hasta memnuniyeti | 0,414 | 0,001** |
| Sistem Yaklaşımı | 0,456 | 0,001** |

r: Pearson correlation p: significant level

**p<0,01

Multiple regression analysis is performed to research effects of TQM practises on operational performance of hospital. It can be seen from Table.4 that "decison making", "relations with suppliers" and "system approach" have positive effect on operational performance.

## TABLE 4. MULTIPLE REGRESSION ANALYSIS OF OPERATIONAL PERFORMANCE

| | B | S.E. | Beta | t | p |
|---|---|---|---|---|---|
| (Constant) | 0,676 | 0,434 | | 10,559 | 0,121 |
| Decision making | 0,218 | 0,115 | 0,183 | 10,887 | 0,061* |
| Process management | -0,063 | 0,097 | -0,064 | -0,648 | 0,518 |

| | | | | | |
|---|---|---|---|---|---|
| Continuous improvement | 0,001 | 0,047 | 0,002 | 0,026 | 0,979 |
| Relations with suppliers | 0,371 | 0,094 | 0,348 | 30,929 | 0,001*** |
| Customer focus | 0,025 | 0,124 | 0,022 | 0,204 | 0,839 |
| System approach | 0,232 | 0,110 | 0,219 | 20,111 | 0,037** |

*p<0.1 ** p<0.05 ** *p<0.001 $R^2$=0.329 S=0,001

Operational performance= 0,676 + 0,218(decision making)+ 0,371(relations with suppliers) + 0,232(system approach)

$R^2$ value between operational performance and TQM practises is 0,329. If p<0.05, explanation rate of decision making is %18,3; explanation rate of system approach is %21,9 on operational performance. If p<0.01 , relations with suppliers explains operational performance at the rate of %34,8.

**Multiple regression analysis of innovation performance:**
Table 5 shows the relationship between TQM practises and innovation performance of hospital. "Continous improvement" is not seen so closely and positive related with innovation performance. But the rest of the TQM practises have significant and positive correlation values at the 0.01 level.

## TABLE 5. CORRELATION VALUES BETWEEN INNOVATION PERFORMANCE AND TQM PRACTISES

| | Innovation Performance | |
|---|---|---|
| | r | p |
| Decision making | 0,442 | 0,001** |
| Process management | 0,488 | 0,001** |
| Continous Improvement | -0,028 | 0,743 |
| Relations with suppliers | 0,518 | 0,001** |
| Customer focus | 0,477 | 0,001** |
| System approach | 0,410 | 0,001** |

r: Pearson correlation p: significant level

**p<0,01

To examine effects of TQM practises on innovation performance of hospital, multiple regression analysis is implemented. Table 6 shows results of six TQM practises regressed on the dependent variable innovation performance. "Decision making", "process management", "relations with suppliers" are more effective on innovation performance.

## TABLE 6. MULTIPLE REGRESSION ANALYSIS OF INNOVATION PERFORMANCE

| | B | S.E. | Beta | t | p |
|---|---|---|---|---|---|
| (Constant) | 0,909 | 0,403 | | 20,253 | 0,026 |
| Decision making | 0,195 | 0,107 | 0,168 | 10,814 | 0,072* |
| Process management | 0,163 | 0,091 | 0,169 | 10,796 | 0,075* |
| Continuous improvement | -0,055 | 0,044 | -0,088 | -10,266 | 0,208 |
| Relations with suppliers | 0,332 | 0,088 | 0,320 | 30,779 | 0,000*** |
| Customer focus | 0,137 | 0,116 | 0,123 | 10,185 | 0,238 |
| System approach | 0,010 | 0,102 | 0,010 | 0,098 | 0,922 |

*p<0.1 ** p<0.05 ** *p<0.001 $R^2$=0,387 S=0,001

| |
|---|
| Innovation performance = 0,909 + 0,195(decision making)+ 0,163(process management)+ 0,371(relations with suppliers) |

$R^2$ value between innovation performance and TQM practises is 0,387. If $p<0.01$, explanation rate of decision making is %16,8; explanation rate of process management is %16,9 and explanation rate of relations with suppliers is %32 on the innovation performance.

**Multiple regression analysis of financial performance:**
The relationship among the TQM practises, operational performance, innovation performance and financial performance is significant and positive at the 0.01 level, except "continuous improvement" relationship between financial performance. It is shown in Table 7.

## TABLE 7. CORRELATION VALUES BETWEEN FINANCIAL PERFORMANCE AND TQM PRACTISES

| | Financial Performance | |
|---|---|---|
| | r | p |
| Decision making | 0,262 | 0,002** |
| Process management | 0,362 | 0,001** |
| Continuous improvement | -0,027 | 0,752 |
| Relations with suppliers | 0,453 | 0,001** |
| Customer focus | 0,282 | 0,001** |
| System approach | 0,252 | 0,003** |
| Operational performance | 0,361 | 0,001** |
| Innovation performance | 0,438 | 0,001** |

r: Pearson correlation p: significant level

**p<0,01

In the multiple regression analysis to measure effects of TQM practises on financial performance this time also added operational and innovation performace. As in the Table 8. "relations with suppliers" and "innovation performance" can explain the variance on financial performance of hospital.

## TABLE 8. MULTIPLE REGRESSION ANALYSIS OF INNOVATION PERFORMANCE

| | B | S.E. | Beta | t | p |
|---|---|---|---|---|---|
| (Constant) | 1,291 | 0,513 | | 2,514 | 0,013 |
| Decision making | 0,009 | 0,136 | 0,006 | 0,063 | 0,950 |
| Process management | 0,150 | 0,114 | 0,136 | 10,314 | 0,191 |
| Continuous improvement | -0,052 | 0,055 | -0,072 | -0,942 | 0,348 |
| Relations with suppliers | 0,308 | 0,119 | 0,260 | 20,590 | 0,011** |
| Customer focus | -0,073 | 0,145 | -0,057 | -0,508 | 0,613 |
| System approach | -0,049 | 0,129 | -0,042 | -0,379 | 0,705 |
| Operational performance | 0,150 | 0,103 | 0,135 | 10,456 | 0,148 |
| Innovation performance | 0,246 | 0,111 | 0,215 | 20,220 | 0,028** |

*p<0.1 ** p<0.05 ***p<0.001 $R^2$=0,287 S=0,001

| |
|---|
| Financial performance = 1,291 + 0,308(relations with suppliers) + 0,246(innovation performance) |

$R^2$ value between financial performance and TQM practises is 0,287. If $p<0.05$, relations with suppliers explains financial performance at the level of %26; innovation performance explains financial perfromance at the level of %21,5.

# 5.FINDINGS AND CONCLUSIONS

The aim of this study is to research the relationship between TQM practises and to identify their effects on the various dimensions of performance. To reach our aim firstly TQM practises have been defined. Related questionnaire is developed and implemented to nurses, doctors, head doctor and department managers in hospital. Based on the responses, results have been analyzed. Reliability and validity of the questionnaire is tested, factor analysis is implemented. To test our hypothesis multiple regression analysis is used. And as a result, except "continuous improvement" the rest of TQM practises; desicion making, process management, relations with suppliers, customer focus and system approach are significant statistically and they have positive relationship between operational, innovation and financial performance of hospital.

-To explain variance on operational performance of hospital; decision making (.218), relations with suppliers (.371), system approach (.232) have direct effects.
-To explain variance on innovation performance of hospital; decision making (.195), process management (.163) and relations with suppliers (.371) have direct effects.
-To explain vriance on financial performance of hospital; relations with suppliers (.308), innovation performance (.246) have direct effects. Also it is necessary to emphasize that "continuous improvement" approach related with TQM practises do not contribute positively to explain performance variance.

A recommendation for further research is to conduct more empirical studies and develop model with more TQM practises. So findings can be more effective to improve performance of hospitals, also other firms. Also this study can be implement both in private and public hospitals to evaluate differences of TQM implementations.

# REFERENCES


Alexander, J.A., Weiner, B.J., Griffith J., (2006), Quality Improvement And Hospital Financial Performance, *Journal Of Organizational Behaviour*, 27: 1003-1029.

Anderson, E.W., Fornell, C., Rust, R. T. (1997), Customer Satisfaction, Productivity And Profitability: Differences Between Goods And Services, *Marketing Science*, 16, 129–145.

Bradley, E., Hartwig, K.A., Rowe, L. A.,Cherlin, E.J., Pashman, J., Wong, R., Dentry, T., Wood, W. E., Abebe, Y., (2008), Hospital Quality Improvement In Ethiopia: A Partnership-Mentoring Model, *International Journal For Quality In Health Care*, 20(6): 392-399.

Benneth, L.M., Kerr, M.A., (1996), A Systems Approach To The Implementation Of Total Quality Management, *Total Quality Management*, 7(6):631-665.

Dean, J.W., Bowen, D.E., (1994), Management Theory And Total Quality: Improving Research And Practice Through Theory Development, *Academy of Management Review*, 19(3):392–418.

Easton, G.S., Jarrel, S.L., (1998), The Effects Of Total Quality Management On Corporate Performance: An Empirical Investigation, *The Journal Of Business*, 71(2): 253-307.

El-Jardali, F., Jamal, D., Dimassi, H., Ammar, W., Tchaghchaghian, V.,(2008), The Impact Of Hospital Accreditation On Quality Of Care:Perception Of Lebanese Nurses, *International Journal For Quality In Health Care*, 20(5): 363-371.

Flynn, B.B., Schroeder, R.G., Sakakibara, S., (1995), The Impact Of Quality Management Practices On Performance And Competitive Advantage., *Decision Sciences*, 26, 659–691.

Forza, C., Flippini, R., (1998), TQM Impact On Quality Conformance And Customer Satisfaction: A Causal Model., *International Journal of Production Economics*, 55, 1–20.

Frei, F. X., Kalakota, R., Leone, A. J., Marx, L. M., (1999), Process Variation As A Determinant Of Bank Performance: Evidence From The Retail Banking Study, *Management Science*, 45, 1210–1220

Fuentes-Fuentes, M.M., Albacete-Saez, C.A., Llorens-Montes, F.J., (2004), The Impact Of Environmental Characteristics On TQM Principles And Organizational Performance, *Omega*, 32:425-442.

Fuentes-Fuentes, M.M., Llorens- Montes, F.J., Fernandez, L.M., (2006), Total Quality Management, Strategic Orientation And Organizational Performance: The Case Of Spanish Companies, *Total Quality Management And Business Excellence*, 17 (3): 303-323.

Gowan, M., Seymou, J., Ibarreche, S., Lackey, C., (2001), Service Quality In A Public Agency: Same Expectations But Different Perceptions By Employees, Managers And Customers, *Journal Of Quality Management*, 6: 275-291.

Harari, O., (1993), Ten Reasons Why TQM Doesn't Work, *Management Review*, 82 (1): 33-38.

Hung, H.M., (2007), Influence Of The Environment On Innovation Performance Of TQM, *Total Quality Management And Business Excellence*, 18 (7):715-730.

Ittner, C. D., Larcker, D. F. (1997), The Performance Effects Of Process Management Techniques, *Management Science*, 43, 522–534.

Kannan, V.R., Tan, K.C., (2005), Just In Time, Total Quality Management, And Supply Chain Management: Understanding Their Linkages And Impact On Business Performance, *Omega*, 33:153-162.

Kaynak H., (2003), The Relationship Between Total Quality Management Practises And Their Effects On Firm Performance, *Journal Of Operations Management*, 21: 405-435.

Kjos, B.O., Botten, G., Romoren, T.I., (2008), Quality Improvement In A Publicly Provided Long-Term Care System:The Case Of Norway, *International Journal For Quality In Health Care*, 20(6): 433-438.

Koumoutzis, N., (1994), Make Behavioral Considerations Your First Priority In Quality Improvements, *Industrial Engineering*, 26, 63–65.

Krause, D.R., Handfield, R.B., Scannell, T.V., (1998), An Empirical Investigation Of Supplier Development: Reactive And Strategic Processes, *Journal Of Operations Management*, 17, 39– 58.

Lemak, D.J., Reed, R., Satish, P.K., (1997), Commitment To Total Quality Management:Is There a Relationship With Firm Performance?, *Journal Of Quality Management*, 2(1): 67-86.

Mann, R., Kehoe, D. (1994), An Evaluation Of The Effects Of Quality Improvement Activities On Business Performance, *International Journal of Quality and Reliability Management*, 11 (4): 29-44.

Martinez-Costa, M., Martinez-Lorente, A.R., (2008), Does Quality Management Foster Or Hinder Innovation?An Empirical Study Of Spanish Companies, *Total Quality Management and Business Excellence*, 19(3): 209-221.

Nilsson L., Johnson M.D., Gustafsson A., (2001), The Impact Of Quality Practises On Customer Satisfaction And Business Results: Product Versus Service Organizations, *Journal Of Quality Management*, 6: 5-27.

Parasuraman, A., Zeithaml, V. A., Berry, L.L., (1985), A Conceptual Model Of Service Quality And Its Implications For Future Research, *The Journal of Marketing*, 49(4): 41–50.

Parkan, C., Wu, M.L., (1997), On The Equivalence Of Operational Performance Measurement And Multiple Attribute Decision Making, *International Journal Prod. Res.*, 35(11): 2963-2988.

Prajogo, D.I., Sohal, A.S., (2006), The Relationship Between Organization Strategy, Total Quality Management (TQM), And Organization Performance- The Mediation Role Of TQM, *European Journal Of Operational Research*, 168: 35-50.

Prajogo, D.I., Sohal, A.S., (2006), The Integration Of TQM And Technology/R&D Management In Determining Quality And Innovation Performance, *Omega*, 34, 296-312.

Puffer, S. M., McCarthy, D. J. (1996), A Framework For Leadership In A TQM Context, *Journal Of Quality Management*, 1, 109-130.

Rad, A.M.M., (2006), The Impact Of Organizational Culture On The Successful Implementation Of Total Quality Management, *The TQM Magazine*, 18(6):, 606-625.

Radovilsky, Z.D., Gotcher, J.W., Slattsveen, S., (1996), Implementing Total Quality Management: Statistical Analysis Of Survey Results, *International Journal of Quality and Reliability Management*, 13 (1): 10-23.

Ragothaman, S., Korte, L., (1999), The ISO 9000 International Quality Registration: An Empirical Analysis Of Implications For Business Firms, *International Journal Of Applied Quality Management*, 2(1): 59-73.

Ravichandran, T. Rai, A., (2000), Quality Management In Systems Development: An Organizational System Perspective, *MIS Quarterly*, 24 (3): 381-415.

Reed, R., Lemak, D.J., Montgomery, J.C., (1996), Beyond Process: TQM Content And Firm Performance, *Academy Of Management Review* 21 (1):173–202.

Reed R., Lemak D.J., Mero N.P., (2000), Total Quality Management And Sustainable Competitive Advantage, *Journal Of Quality Management*, 5: 5-26.

Rodger, J.A., Pendharkar, P.C., Paper, D.J., (1999), Management Of Information Technology And Quality Performance In Healthcare Facilities, *International Journal Of Applied Quality Management*, 2(2): 251-269.

Samson, D., Terziovski, M., (1999), The Relationship Between Total Quality Management Practises And Operational Peformance, *Journal Of Operations Management*, 17: 393-409.

Shetty, Y.K., (1993), The Quest For Quality Excellence: Lessons From The Malcolm Baldrige Quality Award, *SAM Advanced Management Journal*, Spring, 34-40.

Shin, D., Kalinovski, J.G., El-Enein, G.A., (1998), Critical Implementations Issues In Total Quality Management, *SAM Advanced Management Journal*, Winter, 63 (1):10-15.

Shipton, H., Armstrong, C., West, M., Dawson, J., (2008), The Impact Of Leadership And Quality Climate On Hospital Performance, *International Journal For Quality In Health Care*, 20(6): 439-445.

Sıtkın, S.B., Sutchliffe, K.M., Schroeder, R.G., (1994), Distinguishing Control From Learning In Total Quality Management: A Contingency Perspective, *Academy Of Management Review*, 19(3): 537-564.

Stashevsky, S., Elizur, D., (2000), The Effect Of Quality Management And Participation In Decision Making On Individual Performance, *Journal Of Quality Management*, 5, 53-65.

Trent, R.J., Monczka, R.M., (1999), Achieving World-Class Supplier Quality, *Total Quality Management*, 10, 927–938.

Wiklund, H., Wiklund, P.S., (1999), A Collaboration Concept For TQM Implementation In Small And Medium Sized Enterprises, *International Journal Of Applied Quality Management*, 2(1): 101-115.

Wilkinson, A., Redman, T., Snape, E., (1994), The Problems With Quality Management The View Of Managers: Findings From An Institute Of Management Survey, *Total Quality Management*, 5 (6): 397-406.

# MEASURING THE PRE-FLIGHT, IN-FLIGHT AND POST-FLIGHT SERVICE QUALITY OF AIRLINES: A RESEARCH AT DOMESTIC FLIGHTS

**M. Erkan Dursun**
**Onur Air, Quality Department, Turkey**
**Vildan Durmaz**
**Anadolu University, Turkey**

## ABSTRACT

*The main objective of this paper is to determine the level of passenger satisfaction of the domestic airline company services. The questions in the survey consists of services both given by the airline company and the services been outsourced. To identify which company gives at what level satisfactory service lead the airline company to plan properly its services and the partnership for the sustainability in the competitive market.*

*The Turkish domestic market, which was held by Turkish Airlines solely till the latest 2003, is developed via deregulating the market for the private airlines. The decrease in the ticket price due to the increase in the competition caused an incredible passenger demand growth. There are several services provided for the passengers when they arrive at the airport. Those services are provided either by the airlines or the suppliers of the airlines or the government. Those services can be classified as the services pre-flight, in-flight and post-flight. The purpose of this study is to measure of pre-flight, in-flight and post-flight service quality of airlines. This study is supposed to be a guide for the airlines that aim to increase their service quality.*

## INTRODUCTION

In general, quality is defined as the degree of the compatibility of the goods and services provided to the customers' needs and desires. Today, it nearly becomes impossible to be successful for the enterprises which cannot be able to meet the customers' wants and needs. Nowadays, the pre-conditions for the sustainability of airlines in the competitive market are to increase service quality and to correctly analyze the changing passengers' needs and expectations.

Services provided by airlines are not physical objects so the performances and experiences are important for the customers' service quality perception. Performances and experiences differ substantially from service provider and customer to customer. Every interaction between customers and airline employees is likely to influence customers' perceptions of airlines (Gürsoy et al., 2005)

In a highly competitive circumstance the provision of high quality service satisfied by passengers is the core competitive advantage for an airline's profitability and sustained development. I t is commonly believed that higher service quality can lead to a customer's higher overall satisfaction and subsequently to positive behavioral intentions. (Chen, 2008)

## LITERATURE REVIEW

The rapid growth in passenger traffic has been experienced in the deregulated domestic commercial airline market worldwide. Competition is ever increasing as airlines try to acquire and retain customers. Price is initially used as the primary competitive weapon. (Chang and Yeh, 2002)

The air carriers provide a range of services to customers including ticket reservation, purchase, airport ground service, on-board service and the service at the destination. Airline service also consists of the assistance associated with disruptions such as lost-baggage handling and service for delayed passengers. Service quality can be regarded as a composite of various attributes. It not only consists of tangible attributes, but also intangible/subjective attributes such as safety, comfort, which are difficult to measure accurately. Different individual usually has wide range of perceptions toward quality service, depending on their preference structures and roles in process (Tsaur et al., 2002).

There are many empirical studies concerned about service quality (Parasuraman, Zeithaml, and Berry, 1985, 1988, 1991, 1994). The extensively used measure of service quality is SERVQUAL and according to the disconfirmation of expectations model, whenever the performance exceeds the expectations, the expectation is confirmed. Notwithstanding its growing popularity and widespread application, SERVQUAL has been subjected to a number of theoretical and operational criticisms (Buttle, 1996). Despite criticism from other researchers, SERVQUAL remains the most commonly used diagnostic model for evaluating service quality and the development of service quality strategies. (Chen, 2008) Although there has been progress in evaluating the service quality of airlines, most of the work has assumed the attributes of service quality are independent. (Liou and Tzeng, 2007). For this independency, in this context item-item analysis (Aydın, 2007; Buttle, 1996) has been used as a valid and reliable model in airline service quality studies.

Some studies suggested that airline service quality is one of the most critical factors that are likely to influence travelers' airline selection decision and significant relationship exist among reputation, service, and retained preference. Service quality attributes that are perceived as important by airline customers are price , safety, timelines, luggage transportation, quality of service, comfort of the seat, check-in process, and in-board service (Gürsoy et al., 2005)

The delivery of high-quality service became a marketing requirement among air carriers as a result of competitive pressure. Empirical studies of demand for airline services show that service quality is central to the choice of airlines for both business and leisure travelers. Chang and Yeh (2002) argue that quality in airline services is difficult to describe and measure due to its heterogeneity, intangibility, and inseparability.

Airline service is a chain of services in which the entire service delivery is divided into a series of processes. Passengers' expectations of service quality may vary at different stages in the service process. Considering the nature of air transport, air travel is broken into (Chen and Chang, 2005) three stages; pre-flight, in-flight, and post-flight services. Pre-flight services begin with the arrival of the passengers to the airport and end with the boarding. In-flight services consist of the all services on board. And the post-flight services begin with the disembarking of the passengers and end when they leave the airport boundaries.

# RESEARCH

The airline, that was choosen for this study, has the biggest fleet among the private domestic airlines in Turkey. One of the first airline companies that began the domestic services after it was open to the private industry, and has a great load factor with different domestic routes.

The questionnaire was based on a review of the CATS (Corporate Air Travel Survey developed by IATA - International Air Transportation Association) and the passengers' complaints to the airline company. It was pre-tested and revised. (IATA, 2008; IATA, 2007) The questionnaire consists of 3 parts. At part one, respondents were asked to indicate their expectations from any airline company through a five-point Likert scale from "strongly disagree" to "strongly agree". Then, with 24 statements passengers were asked to evaluate the airline company's service quality using the same 5-point scales. The last part dealt with the demographic characteristics of respondents.

Data were collected from passengers using domestic terminal at Atatürk Airport, İstanbul between August 6 and 10 2007 with the permission of airport authority. Then using the item-item analysis on airline service quality dimensions were taken into consideration under the inspiration of previous studies.

The survey questionnaire was randomly given at the domestic terminal baggage claim section. 437 questionnaires were distributed and 415 efficient responses were obtained.

The research questions for this paper are:

- What are the passengers' expectations from the general service quality of an airline company?
- Are the passengers satisfied with the service quality of the airline company?
- Are there any significant differences between the passengers' expectations of pre-flight, in-flight, and the post-flight services attributed?
- Are they going to prefer this company for their next flights?

## FINDINGS

Demographic results of the respondents of the survey are as in follows. (Exhibit 1, 2 3and 4). As it is seen, 65 % of the passengers were men and 34 % were women. The distribution of the respondents' age cumulated at the age between 26 and 44. Of the respondents 57 % stated that their average use of airline services is about 2-5 in a year. Purpose of the last trip of the respondents' mostly was the leisure.

### EXHIBIT 1
**Gender Distribution**

| Gender | Frequency | % of Total respondents |
|---|---|---|
| Female | 143 | 34.46 |
| Male | 272 | 65.54 |
| **Total** | **415** | **100.00** |

### EXHIBIT 2
**Age Distribution**

| Age | Frequency | % of Total respondents |
|---|---|---|
| between 16 and 25 | 83 | 20.00 |
| between 26 and 24 | 156 | 37.59 |
| between 35 and 44 | 122 | 29.40 |
| between 45 and 54 | 40 | 9.64 |
| between 55 and 64 | 9 | 2.17 |
| over 65 | 5 | 1.20 |
| **Total** | **415** | **100.00** |

### EXHIBIT 3
**Average Use of Airline Services**

| Average use of air service | Frequency | % of Total respondents |
|---|---|---|
| once a year | 56 | 13.49 |
| 2-5 in a year | 238 | 57.35 |
| more than 5 in a year | 121 | 29.16 |
| **Total** | **415** | **100.00** |

### EXHIBIT 4
**Purpose of the Trip**

| Purpose | Frequency | % of Total respondents |
|---|---|---|
| Business | 65 | 15.66 |
| Leisure | 350 | 84.34 |
| **Total** | **415** | **100.00** |

Service quality evaluation criteria for *pre-flight services* used in this study are as follows:

UÖSH 1: Waiting time at the security while entering the airport
UÖSH 2: After security check to be directed through the check-in desk efficiently
UÖSH 3: Efficient check-in queuing time
UÖSH 4: Efficiency of check-in personnel
UÖSH 5: Courtesy and helpfulness of check-in personnel
UÖSH 6: To be informed about hand baggage at check-in process
UÖSH 7: After having boarding card to be directed to the boarding gate efficiently
UÖSH 8: Comfort during boarding process
UÖSH 9: After boarding waiting time at the bus
UÖSH 10: During embarking to be directed efficiently
UÖSH 11: On-time performance
UÖSH 12: To be informed if any cancelation/delays

Service quality evaluation criteria for *in-flight services* used in this study are as follows:

UESH 1: Interior look of cabin
UESH 2: Efficiency of cabin temperature/ventilation
UESH 3: Cleanness of seat
UESH 4: Cleanness of lavatories
UESH 5: Professional appearance of cabin crew
UESH 6: Effective service satisfy the passengers' needs and wants
UESH 7: Kind and helpful attitudes of cabin crew
UESH 8: To be able to reach the attention of cabin crew
UESH 9: To be informed by cabin crew and pilots
UESH 10: Meal service (tastes, quantity, appearance etc.)

Service quality evaluation criteria for *post-flight services* used in this study are as follows:

USSH 1: Easily reach to baggage claim after disembarking
USSH 2: Promptness and accuracy of baggage delivery

Service quality of the airline company is evaluated by using the item-item analysis. With this way, it is found the gaps between the expectations and the perceptions of each item. When expectation abstracted from perception the positive result (P1-E1=+) shows that the passenger is satisfied with that item, otherwise not satisfied (Aydın, 2007).

The results of the evaluation of the service quality criteria and the gaps between the expectations and the perception of the service quality are given numerically in Exhibit 5. There, the red one shows the least perceived quality comparing to the expectations. The green point shows the second service that has not expected the passengers' quality standards. The yellow one indicates the third grade of service that did not satisfy the passengers' expectations. The pink indicates the fourth and the blue indicates the fifth bad service comparing to the respondents' expectations.

Respondents stated five gaps to be improved comparing with their expectations:

- On- time performance
- Cleanliness of the lavatories
- Waiting time at the security entering to the airport
- Meal service (quantity, appearance, taste)
- Not informed about the hand baggage at the check-in process.

Due to its complex structure, airline services to the passengers are not only given by the airline company. As it is seen from the result of the survey, passengers were mostly unsatisfied with the outsourced services (from ground operations, security process/personnel and catering). Therefore, the airline company has to deal with not only its service quality but also the services it has been outsourced.

## EXHIBIT 5

**The Results of the Expectations and the Perceptions of the Service Quality Using Item-Item Analysis**

| *Pre-In-PostService* | Perceptions(B)** | Expectations(A)** | (B-A) | Dimensions | Total Gap |
|---|---|---|---|---|---|
| **UÖSH 01** | **4.6173** | **4.0904** | **0.5268** | 0.4289 | 0.4188 |
| **UÖSH 02** | **4.5648** | **4.2279** | 0.3369 | | |
| **UÖSH 03** | **4.6244** | **4.2308** | 0.3936 | | |
| **UÖSH 04** | **4.6830** | **4.2935** | 0.3895 | | |
| **UÖSH 05** | **4.6988** | **4.2618** | 0.4369 | | |
| **UÖSH 06** | **4.6658** | **4.1468** | **0.5190** | | |
| **UÖSH 07** | **4.5739** | **4.2062** | 0.3677 | | |
| **UÖSH 08** | **4.5901** | **4.2526** | 0.3375 | | |
| **UÖSH 09** | **4.6366** | **4.2026** | 0.4340 | | |
| **UÖSH 10** | **4.6575** | **4.2744** | 0.3831 | | |
| **UÖSH 11** | **4.7371** | **4.1823** | **0.5548** | | |
| **UÖSH 12** | **4.7090** | **4.2424** | 0.4665 | | |
| UESH 01 | 4.7044 | 4.2826 | 0.4219 | 0.4045 | |
| UESH 02 | 4.7108 | 4.3218 | 0.3890 | | |
| UESH 03 | 4.8166 | 4.3768 | 0.4398 | | |
| UESH 04 | 4.8092 | 4.2725 | **0.5367** | | |
| UESH 05 | 4.7931 | 4.3779 | 0.4152 | | |
| UESH 06 | 4.7941 | 4.4286 | 0.3655 | | |
| UESH 07 | 4.7956 | 4.4201 | 0.3755 | | |
| UESH 08 | 4.7797 | 4.4194 | 0.3603 | | |
| UESH 09 | 4.6538 | 4.437 | 0.2167 | | |
| UESH 10 | 4.6463 | 4.1222 | **0.5241** | | |
| **USSH 01** | **4.7372** | **4.3778** | **0.3594** | 0.4297 | |
| **USSH 02** | **4.7335** | **4.2335** | **0.5000** | | |

***Perceptions=Perceptions related to the services of the airline questioned**
****Expectation= Passengers' expectations from the perfect airline company (**Aydın, 2007)

# CONCLUSION

This study explored the gap in relation to the passengers' expectations and the service they have received from the airline company/flight.

As a result of the "on-time performance" evaluation, it is found that the airline should maintain an efficient coordination with the ground handling company for increasing their service performance. For most passengers, cleanliness lavatories should be the priority for improvement. This highlights the need for the improvement of the communication between the airline company and the company that the services outsourced. An important finding is that with the efficient cooperation among the companies that some services has been outsourced, service standards and the quality increases to the level of service in response to passengers' needs and wants. In terms of the passengers perceptions they stated that could consider flying on this airline again in the future.

These findings should be taken into account by the airline when making decisions. This study gives a general viewpoint for the key point that is important for the passengers needed to be improved. It is supposed to be a guide for the other private airline companies in Turkey.

# REFERENCES

Aydın, K., "Hizmet İşletmelerinde Servqual Yöntemi ile Hizmet Kalitesinin Ölçümü ve Kocaeli'ndeki Seyahat İşletmelerinden Efe Tur Uygulaması", Sosyal Siyaset Konferansları, 50.Kitabı, (2007) .

Buttle, F., Servqual: review, critique, research agenda, European Journal of Marketing, Vol.30 No.1, 1996.

Chang , Y.-H. and Yeh, C.-H. "A survey analysis of service quality for domestic airlines" European Journal of Operational Research Volume 139, Issue 1, 16 May 2002, p. 166-177.

Chen, Ching-Fu, Investigating structural relationships between service quality, perceived value, satisfaction, and behavioral intentions for air passengers: Evidence from Taiwan, Transportation Research Part A: Policy and Practice Volume 42, Issue 4, May 2008, p 709-717.

Chen, F.Y. and Chang, Y.H., Examining Airline Service Quality From a Process Perspective, Journal of Air Transport Management, 11 (2005), pp. 79-87.

Gürsoy, D., Chen, M.H., Kim, H.J., The US Airlines Relative Positioning Bases on Attributes of Service Quality, Tourism Management 26 (2005) pp. 57-67.

IATA Airport Handling Manual, (AHM) 176-AHM 634-AHM 721. Montreal: IATA Publications, 2007.

IATA, Corporate Air Travel Survey- 2008, Product Information, (www.iata.org/NR/rdonlyres/4F04B692-D4CE-45CC-BE5B-3B1762015842/0/CATS2008ProductInformationPackfinal.pdf).

Liou-James J.H, and Tzeng, Gwo-Hshiung, A non-additive model for evaluating airline service quality, Journal of Air Transport Management Volume 13, Issue 3, May 2007, p. 131-138.

Parasuraman, A., Zeithalm, V.A., and Berry, L. (1985), A conceptual modal of service quality and its implications for future research. Journal of Marketing, 49 (4), p.41-50.

Parasuraman, A., Zeithalm, V.A., and Berry, L. (1988), SERVQUAL: a multiple-item scale for measuring consumer perceptions of service quality, Journal of Retailing 64, p. 12–40.

Parasuraman, A., Zeithalm, V.A., and Berry, L. (1991), Understanding customer expectations of service. Sloan Management Review, 32 (3), p39-48.

Parasuraman, A., Zeithalm, V.A., and Berry, L., "Reassessment of expectations as a comparison standard in measuring service quality: implications for future research", Journal of Marketing 58 (February, 1994), pp. 6.

Tsaur, S.-H., Chang ,T.-Y., and Yen, C.-H., " The evaluation of airline service quality by fuzzy MCDM" Tourism Management Volume 23, Issue 2, April 2002, p. 107-115.

# VALUE ADD LOGISTICS SERVICE QUALITY IN STRATEGIC LOGISTIC MANAGEMENT: CASE STUDY OF HALLEY LOGISTICS

**Pınar Öztürk**
**Istanbul Commerce University, Turkey**

## ABSTRACT

*The case of Halley Logistics is studied to carry logistics strategic management analyses through complementary but non-recursive professional tools in a manner that stimulates theoretical discussion and supports class works. A strategic market-orientation for a superior and a sustainable performance is searched for global sourcing, and supply chain in unionist approach is employed where the core competence view is choosen as the cure at crises periods. Vision-mission statements, values, policies, targets and goals, the functional analyses, five forces of Porter anaylsis, SWOT/PEST Cross matrix, BCG, GE/McKinsey, Ansoff analyses are carried. Groups of ordinal data are assessed with triangulation methods and articulated to cardinal numbers for augmented qualitative meaning in strategic management terms. Findings result that enrichment of value-chain in-house through the evaluation of the expectation-perception gap should be enhenced for derived logistics demand of the chained values based on CSPs of the market knowledge and long-term commitment between shippers and LSPs, and to refrain to invade values of customers or neighbours.*

**Key Words:** Logistic Service Provider, Logistic Service Quality, Strategic Orientation, Collaboration

## INTRODUCTION

Logistics strategic management has dual importance like expertise and collaboration. These two objectives bring the question how that expertise value could be added collaboratively within strategic management context. The objective of this paper is to evaluate in what ways a logistic company could improve its strategic management.

A brief survey of literature is followed by a case study that utilizes strategic management research tools. An analytical generalization is made with respect to the multiple roles of the Logistics Service Provider (LSP) in respect to its collaboration with a shipper in scope of value adding to their businesses.

## LITERATURE REVIEW

Strategic management is important in today's businesses (Eren, 2005: 7). The globalization of businesses has placed demands on logistics, often referred to as the last frontier for the development of strategic advantage and made it a rapidly developing investigation area (Hum, 2000). Global logistics companies act as system integrators for corporate clients (Ross et al., 2007).

Logistics activities (in four Halley's: inbound activities, operations activities, outbound activities, and support activities) are also linked with the traditional activities with those of other disciplines (Novack et al., 1994). So the demand for logistics services is connected throughout the supply chain (Maltz and Ellram, 2000). Logistic functions are discussed in three phase of their development; firstly classical, secondly order management and thirdly global sourcing (Novack et al., 1994). Logistics within supply chain is refereed in unionist approach (rather than relabeling, traditionalist and intersectionist approaches) (Larson and Halldorsson, 2004).

Although logistics is a strategic business function (Makukha and Gray, 2004), it is not necessarily be for strategic items only since it is a derived demand (Maltz and Ellram, 2000). Shippers relied on either their in-house logistic services or single-service logistics providers previously. Strategic advantages of using third-party logistics (TPL) emerged to fill the demand for *integrated* logistics (Maltz and Ellram, 2000: 69) which turns it a strategic buy (Kraljic, 1983), at least in part (Hum, 2000). Relations can start with pure arm's-length transaction to full integration (Webster, 1992). This continuum contains a range of relationship styles: vendor-partner-strategic alliance (Coyle et al., 2003); typical small account relationship-national account selling-strategic alliances-joint ventures (Cooper and Gardner, 1993); fourth-party logistics (KPMG, 2000); and repeat purchase-partnership agreement-TPL arrangements-integrated service agreements (Wood et al., 2002). TPL brings LSPs in four types (value-added logistics services, technology-enabled logistics services, freight forwarding services and full service providers) (Lai, 2004).

TPL company takes over some part of the shipper’s role in their collaborative relation (properties discussed) (Skjoett-Larsen et al., 2003). The best strategy for LSP is to know the processes in shipper (Maltz and Ellram, 2000). In strategizing and operating the collaboration with LSPs (logistics-value-chain), use of financial services providers (financial-value-chain) and information service providers (informational-value-chain) are important in streaming value along value-chain (Lenz et al., 2002; Lewis, 2001).

A *market-oriented* culture is important for superior performance (other than *competitor orientation* or *operational flexibility*) (Kohli and Jaworski, 1990) where a sustainable one can be created with strategic orientation (Gatignon and Xuereb, 1997). *Collaboration* involves an interdependent relationship where the parties work closely together to create mutually advantageous outcomes (Jap, 2001). It could be in joint knowledge creation, expertise sharing, and understanding of the other party's intentions and strategic approaches (Chapman et al., 2002). Shipper-LSP (active at the same level of the supply chain) horizontal collaboration (Cruijssen et al., 2007) could be in four types (coexistence, cooperation, competition, and co-opetition) (Bengtsson and Kock, 1999).

TPL supplies resources/assets that shipper may not have (Lieb and Kendrick, 2003). Combined resources can contribute to strategic advantages (Sinkovics and Roath, 2004). Theoretical factors influencing 3PL-Shipper relationship (Bolumole et al. 2007) are in three fold (The Resource-Based Theory of the Firm, Network Theory, and Transaction Costs Economics).

Business crises as are characterized by low probability/high consequence events that threaten the most fundamental goals of an organization (Weick, 1988). They can significantly hinder organizations from continuing to operate successfully. Three main theories of strategic management have emerged from researches and have been developed for explaining sustainable competitive advantages and superior organizational performance: (1) The traditional *Industrial Organizational* (I/O) view. (McGrath et al, 1995), (2) The *resource-based* view (Wernerfelt, 1984), and (3) The *core competence* view (McGrath et al, 1995). In crisis period there is need to redesign or adapt products (or SBUs). Uncertainties in market, technology and competitors could be handled by new information, technical changes and new organizational arrangements (Erdil et al, 2004).

# CASE STUDY

This case study was prepared by Pınar Öztürk and developed from primary (interview with manager of Halley Logistics) and secondary sources (industrial chambers and company data). The purpose of case study is to stimulate theoretical discussion and to support class works.

# MEASURES AND METHODS

Logistics KPIs (key performance indicators) (Feng and Yuan, 2007) are considered within trends in disintermediation, re-intermediation and disaggregation (Lewis, 2001). Integrated Logistics Indicators are comprehended as multi-echelon optimization of costs, just-in-time deliveries, joint management of inventory with suppliers and logistics partners, and distribution network configuration for optimal staying of inventory (Rai et al., 2006).

Logistics Service Quality (LSQ) is a broader concept than Physical Distribution Service Quality (PDSQ) (Mentzer et al., 2001). Three LSQ dimensions are the level of logistics productivity, or efficiency, achieved by the firm (Coyle et al., 2003); the logistics service performance provided by the firm (Cronin and Taylor, 1992); and the measurement system employed to determine the logistics performance of the firm (Novack et al., 1992). Nine components of LSQ are personnel contact quality, order release quantities, information quality, ordering procedures, order accuracy, order condition, order quantity, order discrepancy handling, and timeliness (Mentzer et al., 2001; Lai, 2004). Financial performance indicators such as ratio analyses are also used.

Vision-and-mission statements, functional analyses, SWOT/PEST analyses, Boston Consulting Halley (BCG) Matrix, General Electric (GE)-McKinsey Matrix and Ansoff Matrix are methods used. Qualitative methods like triangulation are used with quantitative ones. According to Denzig (1970 in Health, 2004: 15903; 1978 in Bryman, 2002: 2), triangulation (τ) in researches could be (1) methodological triangulation, (2) data triangulation, (3) investigator triangulation and (4) theory triangulation.

# COMPANY PROFILE

Halley Logistics International Transportation and Trade Limited Company (fictional company, Halley Logistics Ltd. from this on) is established in 1992 as a forwarder company. Its vehicle investments have started in 1995 while establishing the foundation of the company, now it provides custom services, insurance, storage, custom storage and cargo services, and agency service in Nurnberg Germany with her Halley Europe Logistics GmbH since 2001. Land forwarding specialized Halley Logistics Ltd., carries full truck or parcel loads mainly to Germany with its company-owned 200-vehicle fleet. Halley Logistics Ltd. has R2 license that highest qualification from Turkish Transportation Ministry. Halley Logistics Ltd., does land transportation through the work portfolio of Euroturk (Germany), PSL Freight (England), and Parimpex (Italy). At export market, Halley Logistics mainly transports chemistry, machine limp and break or cut into pieces with metal - aluminums, glass-covered, food and textiles. Halley Logistics Ltd. provides complete logistics services with its own and subsidiaries in logistics sector those provide custom clearance, insurance, warehousing services.

**Integration of the Company:** Halley Logistics believes that they have come up a long way forward then their competitors. Halley Logistics is becoming a strong company by investing in human resources and technology. It provides education for all non-qualified personals. All homeland and foreign drivers have been educated. Halley Logistics is working with professionals to improve the company integration. In **Halley**, %75 of the revenue is gained from main functions and %15-25 of the revenue from subsidiaries for integrated services. Halley Cargo Logistics Distribution and Storage Ltd. provides domestic transport service. Halley Customs Transport and Foreign Trade Ltd. Located at Erenkoy Customs, has 1198 $m^2$ indoor and 520 $m^2$ outdoor storage capacity, and provides storage, loading, packaging, handling services, labeling, repackaging and stock up services. Halley Customs Counseling Ltd. provides services on customs and foreign trading. The company organized strong enough to give full service in Istanbul and around. Halley Insurance Agency Ltd. provides all type of policies (transportation insurance and Casco etc.) that is the agency of Halley Insurance.

**Company Vision:** To have a view of being a logistics company with value chain sharable with customers and suppliers. Such an articulated value chain capability may also refer to be a TPL.

**Company Mission:** Service providers (FSP, IFP) support collaboration join to value chain of customers at their customer side (out-bound) values. (Offensive firms) **Mission Statement:** (1) To emphasize individual development and education to all its employees, (2) To implement high tech group and to create high quality working environment, and (3) To structure according the customer demands of different service and necessities to the market conditions to be efficient and effective way as a proactive company.

**Values** are (1) To place in new world order, (2) To place in knowledge- society, (3) Because knowledge is superior to capital. Capital is scarce, (4) Strategic HRM, (5) Altruistic values, (6) Customer services oriented firm that have vision to be in the front coming strong firms Halley Logistics' mother elementary (for Customer satisfaction is always the first priority, Creating an open and trust relationships with customers, Imposing quality life style to all employees in all levels of the company, and To be able to catch the future investing technology and education)

**Goals:** (1) To be powerful in main left, (2) To have committed employees, (3) To have long-term customers, and (4) To operate partnership in foreign market

Long term targets:

- Halley Logistics Ltd. plans increasing amount of vehicle in the fleet, expending storage capacity for homeland and abroad storages.
- To have strong relationship with foreign agencies.
- Expanding business to England, Italy and France.

Short term targets:

- Trip to Germany : ferry 10 DAYS/Land:8 days
- If there is one car and customs more than one, working accordingly with customs to prevent delaying. Home of cars LOADING and abroad UNLOADING procedures to follow hard to speed up with.
- Land trips to Germany 2 days to Hungary 3 days.
- Investing for new trucks to increase capacity for homeland. Speed up loading and unloading time to prevent delaying.
- Number of new customers : 350 customers (30% should be persistent)
- Planning customer relationship diners
- Identifying target customers and assign representatives
- TO ensure participation to the fairs.
- Polls suggest that the outcome of customer satisfaction with the conduct of the % 76 and above
- All employers have encouraged for meetings and education to work with customer satisfaction at the base.
- Complains to customers services are under percentage 1 of the total customers.
- Employment in and out for drivers under %10 and for management under %10
- To choose right person using kariyer.net and consultant services, controlling references for drivers.

**Quality Activities (Policies):** Halley Logistics Ltd. achieved Quality System Certifications that ISO 9002:1994 in December 2002 and ISO 9001:2000 January 2004 by given international certification center TUV Rheinland (www.tuv.com ) after inspection since Halley Logistics Ltd. started working on quality systems in 2001. Halley Logistics Ltd. has growing success graphic, fallowing international quality standards and doing its best to give highest customer services.

**Functional Analyses**

**Organization** of Halley Logistics Ltd. is a functional one. General Manager is assisted by a General Manager Deputy (Operational) and a General Manager Deputy (Finance and Administrative). General Manager Deputy (Operational) directs to Quality Assurance, Marketing-Sales, IT, HR, Purchasing and Customer Service Managers. General Manager Deputy (Finance and Administrative) directs to Road Transport Group, Facilities and Finance-Accounting Managers.

**Strategic HRM:** Performance evaluation is the realistic and objective determination of employee's level of achievement according to the performance standards. Success of the evaluation gives big contributions to the reaching of company targets. After the evaluation, training needs based on the evaluation and position change are done.

**Expediting-Dispatching:** Halley Logistics Ltd. ensures expeditions comply with the conditions defined previously. Halley Logistics regularly performs highway transportation in direction with its portfolio. Return loads for import are ready for vehicles, which are carrying export loads when the vehicles are on the way.

**Order Management:** After purchase order is received from the customer, Order Entry Form is filled into computer, and necessary precautions are taken. Customer wishes and complaints are appraised.

**Marketing:** The marketing strategy is formed by condensation on the sector and customers are taken as partners. Sector is monitored to increase customer base, enhance operating network and quality and improve price – service effectiveness. The pricing policy for the vehicles is in accordance with the market conditions for either Import or Export.

**Workflow of** Halley Logistics Ltd. can be studied in (I) The Management, (II) The Base Work and (III) The Support by resource management. The Management of Halley Logistics Ltd. (I) is composed of (A)

Management review; and (B) Quality Management System which is made of (1) Document and registration control, (2) Improvement activity and (3) Internal check. The Base Work of Halley Logistics Ltd. (II) is composed of (A) Operations which is made of (1) Import, (2) Export, (3) Customs, (4) Enterprise, (5) Project development-forward and (6) Unsuitable service; and (B) Customer Service which is made of (1) Sales and marketing, and (2) Customer Relations. The Support of Halley Logistics Ltd. by resource management (III) is composed of (1) Training, (2) IT, (3) Accounting-Finance, (4) Vehicle Maintenance and Repair, (5) Human Resources, (6) Administrative, and (7) Purchasing.

Halley Logistics Ltd. is a medium size logistics company with operating capital a little less than a million US$ through a little less than three thousand expeditions for almost thirty two million US$ profit per annum.

# FINDINGS

**Business/Competitive Environment in Porter's Five Forces analysis for Halley Logistics**

**1. Competition:** Halley Logistics is very strong in competition. Its expertise is technologically deep. The high fleet size increases its competitive capability. Small and medium enterprises provide more economic advantages and this is a challenging factor in cost minimizing. The forwarder companies can transport freight with low costs. The forwarders are notable to give receipt. They work with low cost the companies' abroad challenge the rivalry with their high capital.

**2. Entry Barriers:** It is very easy to enter into the logistics sector. The small firms transport without invoices and reduce the costs. But they can operate only in homeland and the entry barriers for Europe are always very high. The scarcity of the educated personnel increases the costs.

**3. Threats of Substitute Products:** Because of the increasing demand, the industry is growing. There are many substitutes for Halley Logistics. However none of them is an equivalent for Halley Logistics.

**4. Bargaining Power of Buyers:** Bargaining power of buyers is relatively high in accordance with the other industries. Most of the buyers are manufacturers Halley Logistics cares about the purchasing power of the buyers of its products. However, Halley Logistics gains competitive advantage with strategic partnerships in the countries, in which it operates. The fairs provide a good possibility to gain new customers. The marketing team visits new and old customers. Recently, the increasing focus on environmental protection has led to significant changes in logistics processes. In addition to the distribution process to the customers, re-usable packaging and goods to be recycled or remanufactured have to be transported in the reverse direction. If both tasks have to be performed simultaneously at the customers' locations, which are serviced by a fleet of vehicles stationed in a depot or distribution/redistribution center, the vehicle routing problem with simultaneous delivery and pick-up arises.

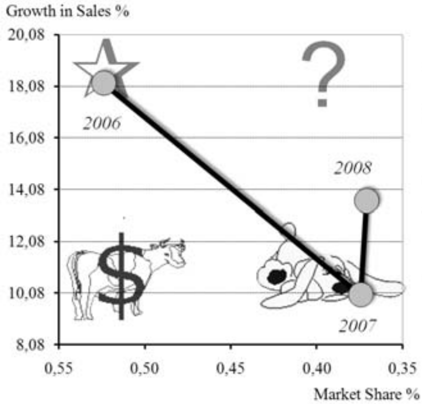
**5. Bargaining Power of Suppliers:** The suppliers are very important in this sector (Truck, repair, supplier, wheel, gas) because of the usage time and reliability. Halley Logistics works with strong firms in its distribution channels. Power of sellers of Halley Logistics generally depends of the strategic partnerships and fleet size.

SWOT/PEST Cross Analyses of Halley is given in Fig. 1.

| | Political | Economic | Social | Technological |
|---|---|---|---|---|
| **Strength** | Turkey access to European Community. | Having the base country Turkey, center of location and land transport is national defense supported.<br>Wide spread subsidiaries and partnerships in Europe. | Wide societal network.<br>High level integration with customers in social events. | Proprietary expertise in the service, supported by patented technology, affording a competitive advantage and enabling to maintain Halley's market leading positions |
| **Weakness** | Termination provisions customary for government contracts. The Government retains the right to terminate such contracts at its convenience | Poor Return on Assets, Poor Leverage Margin and poor Return on Investment | Weakness of online social networking services | Adopting to expensive technological requirements |
| **Opportunity** | Turkey, at the crossroads of a 600 billion dollar worth flow of goods, ranks 34th in the "Global Logistics Performance Index" of the World. | The company lacks scale when compared to its international competitors in the market. Many of its competitors are much larger in terms of size, revenues and number of employees. | Young and dynamic domestic population | Wireless technology<br>Satellite technology |
| **Threat** | Cost of transport permit quotas by the EU countries<br>Barrier to free trade through labor and service immobility.<br>Vulnerability because of war.<br>Political instability<br>Unexpected changes in regulatory environments | Trust risk<br>Potentially adverse tax and duties consequences | Shrink in social affiliation<br>Discrimination according to country of origin. | The Climate conditions like snow and rain can postpone the delivery.<br>Customs laboratory inspections |

Fig. 1: SWOT/PEST Cross Analyses of Halley

Boston Consulting Group (BCG) Matrix of Halley Logistics (Fig. 2) is plotted business growth rate (growth in sales %) versus relative position in the market (market share %) in three years term. Halley Logistics data base is used for business growth rate figures and they are articulated with size of the existing market figures obtained from balance of payments statistics of the Central Bank for figures of relative position in the market. Halley invests business during 2006-2007 term and liquidities business during 2007-2008 term (t=2006, 2007 and 2008).



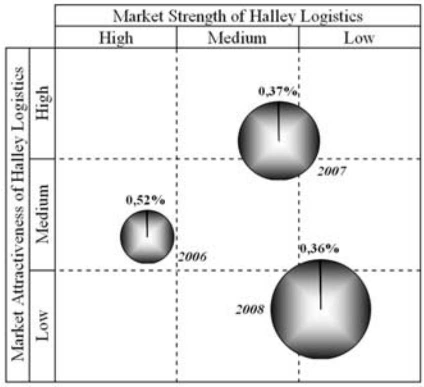



Fig. 2: BCG Matrix of Halley    Fig. 3: GE/McKinsey Matrix of Halley

Strategic management success factors of Halley Logistics are then analyzed by General Electric and McKinsey matrix (Fig. 3) that is prepared in consideration of Porter Five competitive forces model, SWOT and PEST analyses (as of $c_{MS}$ and $c_{MA}$) with analyses on Financial Ratios (FR), Liquidity Ratios (LR), especially Asset Utilization Rate (AUR), other Operation Ratios (OOR), Profit Ratios (PR). Financial ratios are assessed ($\tau$) in the scope of other analyses in consideration of Integrated Logistics KPIs (key performance indicators) such on-time deliveries, joint management of inventory with suppliers and logistics partners. Groups of ordinal data are assessed ($\tau$) with triangulation methods and articulated to cardinal numbers for augmented qualitative meaning in strategic management terms for Market Attractiveness (MA) and Market Strength for years (t=2006, 2007 and 2008).

$$MS_t = c_{MS}\frac{\tau(AUR)+\tau\left(\sum_{i=n}^{n} OOR_i\right)+\tau\left(\sum_{j}^{m} FR_j\right)+\tau\left(\sum_{d}^{g} LR_d\right)}{n+m+g+1}$$

$$MA_t = c_{MA}\frac{\tau\left(\sum_{k=1}^{q}\left(\text{Integrated Logistics KPIs}\right)_k\right)+\tau\left(\sum_{h=1}^{s} PR_h\right)}{q+s}$$

Cardinality is provided by set of data from functional analyses with the set of elements of High-Medium-Low assessment spectrum. Plots of figures on General Electric and McKinsey matrix are more than their location on the matrix, sizes of plots represent size of market and they contain market share figures as well.

Ansoff matrix (Fig. 4) is developed as per corporate growth objectives with higher priorities are considered.

| | Existing Product (or SBU) | New Product (or SBU) |
|---|---|---|
| **Existing Market** | **Market penetration:**<br>Equip trucks with GPS and SMS for informing customers for status of their expedition.<br>Long-term agreements with bigger companies (preferably JVs) for bigger contracts with regular payments | **Product development:**<br>Develop Returnable Pallet Service<br>3rdPL (TPL)<br>Maritime JV<br>Open bonded warehouses<br>Operate transhipment centres |
| **New Market** | **Market development:**<br>Parcel loads market (for SME)<br>Less than Truckload (LTL) market<br>England, Italy, France, Russia, Ukraine, Poland, Slovakia, Czech, Romania and Middle East markets.<br>The food and foodstuff companies | **Diversification:**<br>Refrigerated transport (cold-chain) fleet<br>4thPL on textile<br>Barter on export market for import |

Fig. 4: Ansoff Matrix for Halley

Steps from Market penetration, to Market development, and to Product development and then to Diversification cover doubled risk perceptions stepwise. Market penetration and Market development phases require enrichment of value-chain in-house. On contrary, Product development phase requires to consider that demand is derived demand, so should the values be chained accordingly. In Diversification, Halley is expected to invade values of its customers or to adopt values of some neighbouring business domains.

# CONCLUSION

Foreign market activities and foreign customer contacts are important for value add LSQ in strategic logistic management. The complexity of the quality concept (Brito et al., 2007) is held for the expectation-perception gap (Parasuraman et al., 1988) and performance measures (Cronin and Taylor, 1992). Agreed with Panayides (2007) that organizational learning in LSP-Shipper relationship may be positively related to improvement in LSQ. Coincided with Carbone and Stone (2005) that market knowledge and long-term commitment between shippers and LSPs, are CSPs (Critical Success Factors).

Return to *core competence* view (McGrath et al, 1995) is much recommendable for Halley Logistics Ltd. during this crisis period and it is worthwhile to improve its Logistics Service Quality (LSQ) capabilities towards TPL but refrain from fourth party logistics for the time being.

# REFERENCES


1. Bengtsson, M. and Kock, S. (1999), ‘Cooperation And Competition In Relationships Between Competitors In Business Networks’, *The Journal of Business & Industrial Marketing*, 14 (3) 178-194.
2. Bolumole, Y., Frankel, R. and Naslund, D. (2007), ‘Developing a Theoretical Framework for Logistics Outsourcing’, *Transportation Journal*, 46 (2): 35-54.
3. Brito, E.P.Z., Aguilar, R.L.B. and Brito, L.A.L. (2007), ‘Customer Choice of a Car Maintenance Service Provider: A Model to Identify The Service Attributes that Determine Choice’, *International Journal of Operations & Production Management*, 27 (5): 464-481.
4. Bryman, A. (2002), ‘Triangulation’, *Encyclopedia of Social Science Research Methods*, Sage Publications, London, 1-5.
5. Carbone, V. and Stone, M.A. (2005), ‘Growth and Relational Strategies Used by the European Logistics Service Providers: Rationale and Outcomes,’ *Transportation Research*, E-41 (6): 495-510.
6. Chapman, R.L., Soosay, C. and Kandampully, J. (2002), ‘Innovation in Logistic Services And The New Business Model: A Conceptual Framework’, *Managing Service Quality*, 12 (6): 358-371.

7. Cooper, M.C. and Gardner, J.T. (1993), ‘Building Good Business Relationships - More Than Just Partnering Or Strategic Alliances’, *International Journal of Physical Distribution & Logistics Management*, 23 (6): 14-26.

8. Coyle, J.J., Bardi, E.J. and Langley, C.J. (2003), *The Management of Business Logistics: A Supply Chain Perspective*, Mason, OH: South-Western Thomson Learning.

9. Cronin, J.J. and Taylor, S.A. (1992), ‘Measuring Service Quality: A Reexamination and Extension’, *Journal of Marketing*, 56 (3): 55-68.

10. Cruijssen, F., Dullaert, W. and Fleuren, H. (2007), ‘Horizontal Cooperation In Transport And Logistics: A Literature Review’, *Transportation Journal*, 46 (3): 22-39.

11. Erdil, S., Erdil, O., Keskin, H. (2004), ‘The Relationships between Market Orientation, Firm Innovativeness and Innovation Performance’, *Journal of Global Business and Technology*, 1 (1), 1-11.

12. Eren, E. (2005). *İşletmelerde Stratejik Yönetim ve Işletme Politikası*, İstanbul: Beta Basım Yayım Dağıtım.

13. European Commission, *The EU Emissions Trading System,* 2008 Ed., Belgium, p. 28.

14. Feng, C. and Yuan, C. (2007), ‘Application of Collaborative Transportation Management To Global Logistics: An Interview Case Study’, *International Journal Of Management*, 24 (4): 623-636.

15. Gatignon, H. and Xuereb, J. (1997), ‘Strategic Orientation of the Firm New Product Performance’, *Journal of Marketing Research*, 34 (1): 77-90.

16. Health, L. (2004), ‘Triangulation: Methodology’, *International Encyclopedia of the Social & Behavioral Sciences*, 15901-15906.

17. Hum, S.H. (2000), ‘A Hayes-Wheelwright Framework Approach For Strategic Management of Third Party Logistics Services’, *Integrated Manufacturing Systems*, 11 (2): 132-137.

18. Jap, S.D. (2001), “ ‘Pie Sharing’ In Complex Collaboration Contexts”, *Journal Of Marketing Research*, 38 (1): 86-99.

19. Kohli, A.K. and Jaworski, B.J. (1990), ‘Market Orientation: The Construct, Research Propositions, and Managerial Implications’, *Journal of Marketing*, 54 (2): 1-18.

20. KPMG (2000), *Outsourcing Logistics: Status, Issues and Trends in Partnerships*, Rotterdam: KPMG Transportation and Distribution.

21. Kraljic, P. (1983), ‘Purchasing Must Become Supply Management’, *Harvard Business Review*, 61 (5): 109-117.

22. Lai, K. (2004), ‘Service Capability and Performance Of Logistics Service Providers,’ *Transportation Research*, E-40 (5): 385-399.

23. Larson, P.D. and Halldorsson, A. (2004), ‘Logistics versus Supply Chain Management: An International Survey’, *International Journal of Logistics: Research & Applications*, 7 (1): 17-31.

24. Lenz, M., Zimmermann, H. and Heitmann, M. (2002), ‘Strategic Partnerships and Competitiveness Of Business-To-Business E-Marketplaces: Preliminary Evidence From Europe’, *Electronic Markets*, 12 (2): 100-111.

25. Lewis, I. (2001), ‘Logistics and Electronic Commerce: An Interorganizational Systems Perspective’, *Transportation Journal*, 40 (4): 5-13.

26. Lieb, R.C. and Kendrick, S. (2003), ‘The Year 2002 Survey: CEO Perspectives On The Current Status And Future Prospects Of The Third-Party Logistics Industry In The United States’, *Transportation Journal*, 42 (3), 5-16.

27. Makukha, K. and Gray, R. (2004), ‘Logistics Partnerships between Shippers and Logistics Service Providers: The Relevance of Strategy’, *International Journal of Logistics: Research & Applications*, 7 (4): 361-377.

28. Maltz, A.B. and Ellram, L.M. (2000), ‘Selling Inbound Logistics Services: Understanding The Buyer's Perspective’, *Journal of Business Logistics*, 21 (2): 69-88.

29. McGrath, R.G, MacMillan, I. C. and Venkatraman, S. (1995), ‘Defining and developing competence: A strategic process paradigm’, *Strategic Management Journal,* 16, 251-275.

30. Mentzer, J.T., Flint, D.J. and Hult, G.T.M. (2001), 'Logistics Service Quality as a Segment-Customized Process', *Journal of Marketing*, 65 (4): 82-104.

31. Novack, R.A., Rinehart, L.M. and Langley, C.J. (1994), 'An Internal Assessment of Logistics Value', *Journal of Business Logistics*, 15 (1): 113-152.

32. Novack, R.A., Rinehart, L.M. and Wells, M.V. (1992), 'Rethinking Concept Foundations In Logistics Management', *Journal of Business Logistics*, 13 (2): 233-267.

33. Panayides, P. (2004), 'Logistics Service Providers: An Empirical Study Of Marketing Strategies And Company Performance', *International Journal of Logistics: Research And Applications*, 7 (1): 1-15.

34. Panayides, P.M. (2007), 'Effects Of Organizational Learning In Third-Party Logistics', *Journal of Business Logistics*, 28 (2): 133-158.

35. Parasuraman, A., Berry, L. and Zeithaml, V. (1988), "SERVQUAL, A Multiple-Item Scale For Measuring Consumer Perceptions Of Service Quality", *Journal of Retailing,* 64 (1): 12-40.

36. Rai, A., Patnayakuni, R. and Seth, N. (2006), 'Firm Performance Impacts Of Digitally Enabled Supply Chain Integration Capabilities', *MIS Quarterly*, 30 (2): 225-246.

37. Ross, A., Jayaraman, V. and Robinson, P. (2007), 'Optimizing 3PL Service Delivery Using A Cost-To-Serve And Action Research Framework', *International Journal of Production Research*, 45 (1): 83-101.

38. Sinkovics, R.R. and Roath, A.S. (2004), 'Strategic Orientation, Capabilities, and Performance in Manufacturer - 3PL Relationships', *Journal of Business Logistics*, 25 (2): 43-64.

39. Skjoett-Larsen, T., Thernøe, C. and Andersen, C. (2003), 'Supply Chain Collaboration: Theoretical Perspectives and Empirical Evidence', *International Journal Of Physical Distribution & Logistics Management*, 33 (6): 531-549.

40. Webster, F.E. (1992), 'The Changing Role of Marketing In The Corporation', *Journal Of Marketing*, 56 (4): 1-17.

41. Weick, K.E. (1988), 'Enacted Sense Making in Crisis Situations', *Journal of Management Studies,* 25 (4), 305-317.

42. Wernerfelt, B. (1984), 'A resource-based view of the firm', *Strategic Management Journal,* 5, 171-180.

43. Wood, D.F., Barone, A.P., Murphy, P.R. and Wardlow, D.L. (2002), *International Logistics,* New York: AMACOM Books.

# THE RELATIONSHIP BETWEEN THE STRATEGIC PLANNING (STRATEGIC MANAGEMENT SYSTEM) AND QUALITY IMPROVEMENT IN UNIVERSITIES

**Abdullah Karakaya**

**Karabuk University, TURKIYE**

## ABSTRACT

*The main object of this paper is to investigate the interaction between the quality improvement system and strategic planning/strategic management system (SP/SMS) at universities which are responsible from training qualified human resource that are the prerequisite of the social improvement and development. For this purpose, the similarities and differences between both systems were determined before considering what kind of significant applications can be done to assure the harmonization of these systems. Strategic management system focuses on realizing the long term goals of a university. For realizing the strategic goals of the university, it is important to provide high quality services along with respecting the philosophy of continuous quality improvement.*

*There are two sections in the study as the theoretical and practical parts. In the theoretical part of the study, a literature survey will be presented including the quality, service quality, quality management systems, quality improvement, and strategic planning (strategic management system) concepts with their definition, processes and stages. In the application part of the study, a case study is presented which seeks how to harmonize the academic evaluation and quality improvement (AEQI) activities with the strategic planning activities both of which have been being conducted at Karabuk University.*

*Descriptive research model is used in the study. After the evaluation of data collected from the selected university by document inspection, face-to-face interview, and observation methods, it is concluded that the AEQI, and the strategic planning works in the university are being tried to be partly harmonized. It is also observed that the processes and performance indicators that are being used in AEQI are being planned to be used in strategic management system. Improving and maintaining the coordination and harmony between the quality improvement activities and the strategic management system would affect the individual and organizational performance positively.*

## INTRODUCTION

The fast and continuous change in the world significantly affects all the organizations making the current goals and strategies inadequate and invalid, and risking the survival of the organizations in an uncertain environment brought about by newly arising problems. Survival of an organization with maintaining its sustainable competitive advantage in such an environment requires knowing the environmental conditions, reacting to this environment as appropriate, making itself different from its competitors, being more flexible and adopting and responding to the changing conditions fast. The responsibility of providing goods and services meeting the diversity and increase in the needs and demands of the society is one of the important factors affecting the organizational success. Increasing importance and recognition of the customer satisfaction, intensive competition conditions, and the quality awareness throughout all areas, have led to the innovations in the management approaches.

Fast and instant changes in the higher education system in our country have brought at least one university in each city which promoted a competition among the universities. Universities have to develop and apply new and up-to-date approaches in management to gain a competitive advantage. With these developed approaches, universities can gain advantage in managing the competition by maintaining the continuity of the quality improvement within the holistic frame of the strategic management system. It is obvious that a combination which best fits the social, organizational and individual benefits should be chosen to make the approaches that will be used reach its goals.

There are increasing number of applications in organizations on quality management and strategic management. It is necessary to integrate the strategic management and quality management system which requires continuity. It should be noted that the executive managers are of critical importance in this process. Executive managers' responsibility for the determination of the long term goals, direction and manner of the organization also contains the effective and applicable strategies of the organization. Thus the vision and abilities of the executive management system is the fundamental determinent factor.

## Strategic Planning (Strategic Management Systems)

Some of the definitions of strategic management concept which can be defined in various ways according the point of view are given below as they are related to the subject of this study. Strategic management is not interested in the daily and usual operations of the organization but rather it is about managing the activities which enable the long term survival of the organization and provide competitive advantage and a profit over the average profit. (Ülgen&Mirze, 2006; 25-26). Strategic management system is the sum of decisions and activities which can contribute to survival and continuous and successful development of the organization by fast adaptation to the changing environmental conditions. Strategic management enhances an organization's potential to improve its performance or competitive advantage by providing "a means of competing not permitted by the pure market pursuit of goals". For this reason, strategic political management may be an important component of overall organization strategy (Oliver&Holzinger, 2008; 496).

Strategic management system is different from the other management systems because it comprises the general management system, it is a function of executive management, it is exposed to social responsibility more intensely, it is related to the long term goals and focused to the future, and its decision making processes requires more qualitative and profound knowledge etc. (Dinçer 2007; 36-38). With these features, strategic management constructs the mission, vision, strategic goals, strategies and actions according to these strategic goals (Murat&Bağdigen, 2008: 67). An effective strategic management system which is correctly designed with system integrity improves the organizational performance. Strategic management can be implemented in three different ways, which are bottom-up, top-down or collaborative processes. Among them top-down approach is the most common one (Nuroglu&Nuroglu, 2008; 1029).

Strategic management is the sum of processes of research, investigation, evaluation and choosing efforts required for the planning of the strategies, taking and executing the any kind of structural and motivational measures needed to apply the planned strategies, applying the strategies, and controlling the results for the conformance to the goals (Eren, 2005; 25). Strategic management process is generally a result of a planning function and also reflects a rational, integrated and proactive approach. This approach requires the strategic planning and management to consider many alternatives, test the goals related to these alternatives, evaluate the cost and risks of some possible results, collect a large amount of data/knowledge, and objectively analyze data/knowledge and probability calculations (Alpkan, 2000; 3-4).

Strategic management process is comprised of three major stages as; development, choosing and planning of the strategies of the organization, executing the strategies and control of the strategic results (Prasnikar et al., 2005; 260). This process which is defined as its main stages is actually the form of general management process adapted to strategic subjects and involves; determination of the goals, execution of the activities required reaching the goals, and controlling of the conformance of the activities to the goals. Thus, it is not true to define the strategic management system as only the strategic planning stage (Eren, 1990; 15). T.R. Prime Ministry State Planning Organization (SPO) has also used strategic planning concept as to include strategic management process as a whole in "Strategic Planning Guide for Public Administrations" (DPT, 2006; 4).

Although there are stages of strategic management system and a procedure and logic based sequence among the activities in these stages, it doesn't mean that one stage cannot begin without the other stage ends. These stages are only a simpler and categorical classification of a complex and multi-dimensional interaction process (Alpkan, 2000; 5). In fact these stages are not restricted and sequential but they are interfering and complementary stages.

# Quality Improvement (Quality Management Systems)

## Quality

Quality concept has arisen from the desire for the human beings and systems not to make mistake and to reach the excellence. Quality, which has a multi-dimensional and inter-discipliner nature, is related to the user needs and expectations which are changing continuously. Quality is a subjective concept which can change according to the features, social statue, and economical condition of the consumer and can change its form according to the different needs and expectations. Needs, expectations, social and economical environment, cultural and religious structure, conventions, economical level, technology, climate, geography, education, general social judgments affects directly or indirectly the perception of the quality by the customer (Sözer et al., 2002; 46). Quality has become a favorite subject of study in the managerial science for its relation with the efficiency, organizational behavior, effective management, customer satisfaction, and strategic advantage etc. In this study, quality is taken as a strategic instrument which is used to reach a sustainable competitive advantage by improving the operational performance and cost saving.

## Service Quality

Quality in service sector is mainly affected by the external factors rather than producer. There are various studies on defining and measuring the service quality. The service quality can be defined as the satisfaction level of the consumer (consumer quality expectations). Consumer quality expectations have two dimensions as the desired level of the quality and acceptable level of the quality. Service quality is the difference between the percepted quality of service and the expected quality of service. If the service quality is equal to or more than zero, the consumer is satisfied and the service quality evaluation becomes positive (Aksoy, 2005; 93-94). Quality is a dynamic concept which changes very fast and cannot be restricted to some standards as it involves many variables (Şişman, 2002; 17). Just like many concepts in business life, it is clear that the quality needs to be adapted to the time and environment in front of the changing environmental condition and customer expectations. Continuous improvement is an important concept in quality (Bumin&Erkutlu, (2002; 84-85).

## Quality Management System and Quality Improvement

Since increased quality has been shown to contribute to greater market share, better returns on investments, lower manufacturing costs, improved productivity, and improved strategic performance, a growing number of firms are placing emphasis on improving quality (Chen&Chen, 2009; 49-50).

Quality management system can be defined as transforming quality from being a statistical application to a managerial philosophy and approach (Koçel, 2003; 385). Quality management includes systematical activities relating to the strategic planning, funding and evaluation with the leadership of the management and contribution of all employees (Efil, 2006; 49). Quality management includes three procedures as quality planning, quality control, and quality improvement. Quality improvement is the activities to implicate the quality improvement to the organizational culture and become a continuous effort in the organization. It involves an organization which supports the quality improvement process (Bumin&Erkutlu, 2002; 87-88).

The benefits of Quality Management System are improved customer satisfaction, quality of goods and services, productivity, delivery times, employee participation, and employee satisfaction as well as reduced waste, inventory, cost, product development time, and work-in-process among others (Sadikoglu&Zehir, 2008: 1037). The basic principles of the quality management system, which has three components defined as human, process and customer, can be listed as; strategic planning, customer-focused, leadership, team spirit and participation of the employees, process approach, system approach, continuous improvement, knowledge systems, cooperation with the suppliers, giving importance to education. (Kıngır, 2007; 41-42& Özer, 2008; 243-249).

The implementation of quality management system can produce significant benefits. The most important is that organizations are able to focus on areas that require improvement. Another important benefit is increased awareness (within the organization) of the potential effects of poor quality on overall business results. The use of quality management systems (quality-costing techniques) can be useful even if an organization has developed a sophisticated quality management system (Yang, 2008:175-176).

Quality Management System encompasses a set of critical factors, which is a primary strategy to achieve and maintain excellent organizational performance. Following, strategy is 'actions or patterns of actions intended for the attainment of goals'. If the Strategic Management System and Quality Management System can be harmonized and used effectively in coordination with each other excellent organizational performance can be attained. To benefit from this cooperative use of two management systems following factors have critical importance; commitment of the executive management, strategic planning, being customer-focused, benchmarking, human resource management, relationship with suppliers, continuous improvement, quality information system, service design, and social responsibility (Abas&Yaacob, 2006;161).

# 2. CASE STUDY: INVESTIGATION OF THE AEQI AND SP/SMS STUDIES IN KARABUK UNIVERSITY

## 2.1. Definition of the Study

Universities which are founded in our country in recent years differ from each other with mainly their human resources, financial resources, people, place of foundation, and organizational culture etc. For this reason, the scope of the study was restricted to the universities newly found to ensure more reliable results from a case study which is oriented towards a certain area. Considering the obtainability of data, ease of applicability, time, and cost, Karabuk University was chosen as the subject for the case study.

Karabuk University has five faculties, two institutes, two vocational colleges and it is one of the youngest universities in our country. Karabuk University which adopted the entrepreneur university model that graduates are more active in global business market, aims to provide quality education-training service to a larger number of people with its departments that are currently founded and will be founded in the near future. It also aims to become a prestigious university in the region and the country, and to be recognized worldwide. Karabük University provides multi-dimensional services to its social interest groups with social and cultural activities by a social responsibility.

Increasing pressure of the conditions of information society on the economical and social life increased the importance of the universities in the regional and national development. The main reason of this study is the need for the studies towards the solution of the problems that new universities, which are trying to increase their market shares, experiences. In this context, Karabuk University has an important place among the newly founded universities looking at the foundation and development progress due to following reasons;

- Being founded in Karabuk where a new city had been born after the foundation of the first heavy industry plant of our country.
- Being in a region that has industry culture and substructure
- Giving the conscious of development to the society with the leadership of the university.
- Being in a geography that is under the protection of FAO for its forests and natural diversity.
- Having many cultural and touristical values such as Hadrianapolis and Safranbolu which is under protection of UNESCO among the World Heritage Cities.
- Having departments which are integrated with the region.

## 2.2. Purpose of the Study

The main purpose of this study is to investigate the structure of the quality improvement activities that has been conducted in Karabuk University and the interaction of these activities with the strategic planning. For this purpose, applications related to the main stages of the strategic management system which are; strategic planning, strategic application and strategic control stages were investigated. Also the processes of the quality management system were investigated which are; inputs, corporate features and properties, education-training, knowledge production, application and service, administrative and support processes, managerial properties, outputs and database construction. Harmonized applications were sought that can meet the requirements of both systems and establish the necessary integration between the quality improvement and strategic planning studies in Karabuk University. Some of the subjects investigated in the study are; processes of the quality management system, stages of the strategic planning, and harmonized applications between these two systems.

## 2.3. Method

Descriptive research model is used in the study which enables the presentation of a case study within its framework (Altunışık et al., 2007; 255-256). In this study, data related to the process of foundation of Karabuk University, its aims, the studies on the quality improvement and strategic planning (strategic management system) was obtained by document inspection, observation, and face-to-face interview (university managers, academic and administrative personnel, students, public administrations, private sector, and NGOs).

## 2.4. Data Analysis and Findings

Data obtained for the study with various methods was analyzed for three aspects; Development Plan, Academic Evaluation and Quality Improvement (AEQI) and Strategic Planning/Strategic Management studies. After the foundation process of Karabuk University, Development Plan and then AEQI report were prepared with the intensive support of the executive management and self-sacrificing studies and willingness based organization of all employees, although there wasn't a legal requirement to do these studies at once. The organization scheme of the mentioned organization is presented in Figure 1.

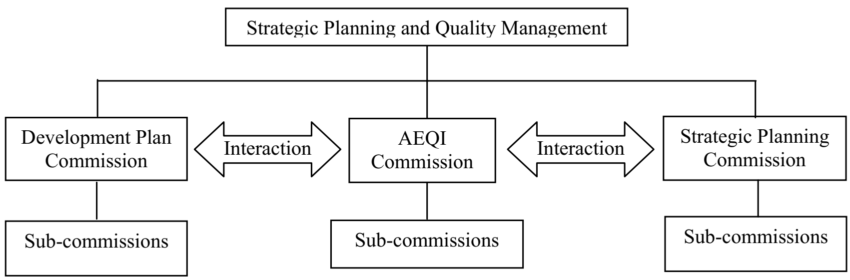



Figure 1: Organization Scheme of DP, AEQI, and SP

According to the evaluation of AEQI studies it was determined that the executive managers of the university believe in the importance of the service quality in higher education. I was observed that the quality management systems are being tried to be executed with the leadership of the executive management of the university. For this purpose AEQI commission and nine sub-commissions were constructed. 2008-AEQI report was completed in May-2009 with the active and coordinated participation of AEQI commissions and sub-commissions.

Strategic planning studies were started by constructing the Strategic Planning Commission and Strategic Planning Sub-commission and 2011-2015 term strategic plan has been being prepared in harmony with AEQI report and Development Plan. Studies related to the Development Plan have started in August 2008 and have been prepared as to include the 2009-2025 term and finished in December 2008, for coordination with Strategic Plan. This development plan is approved by the State Planning Organization. It is forecasted in the Development Plan that the differentiation, growth, and cost saving strategies of the university shall be harmonized with the Strategic Planning and AEQI studies. It was observed that these strategies are supported by the functional strategies such as; marketing, human resources, financing and information technologies. Because the Strategic Plan has not been put into affect yet, no consideration on strategic application and control has been done.

# RESULTS AND DISCUSSION

Survival of an organization today which requires competition and being successful depends upon monitoring the changes and rivals in the sector, adapting to the change in time, and proactively managing the change. The interaction among the Development Plan, AEQI, and strategic management system which are the important means of managing the change in university were investigated in the study. It can be said that these systems works in this university with an acceptable harmony as to complement each other's stages and processes. In this context, the mission and vision defined in Development Plan plays critical role in determining the strategies. It can be said that this situation improves the effectiveness and efficiency of Strategic Plan studies. The areas that form the base for AEQI studies prepare a substructure for Strategic Planning system especially simplifying the SWOT, determining the processes and the performance criteria stages.

It can be said that harmonization of the applications of process focused strategic management system related to the strategic consciousness, strategic orientation, strategic analysis and strategy development stages contributes to the organizational success. Having a formal document and Development Plan expressing the mission, vision, and values, meaning the strategic orientation of the organization, provides support for choosing strategic goals, determining the place of the organization in the future, and gives the opportunity to focus on futuristic studies rather than struggling daily works. It was seen that an environmental analysis and synthesis have been done by gathering data and knowledge with formal and informal methods for the strategic analysis and the strategies were determined according to the results of this investigation. Strategies, developed depending on the data, obtained from a strategic analysis of desired quality, would contribute to the realization of the university goals according to the rationality principle which is important for the university to gain competitive advantage. Thus, new strategies which are compatible with the university's environment, capabilities and expectations, can be developed and applied, taking the competitors into consideration.

Some of the factors that can negatively affect the university are; continuous economical, political and administrative uncertainties, educational services and university consciousness which are not at a desired level, new alternatives (distance learning), existence of powerful state universities in the market, serious decrease in employment opportunities offered by Kardemir, and immigration from the city. These sectoral and local problems may weaken the financial support to the university and may lead the university to be percepted as "industry without chimney". Holistic strategic management system should be adopted and applied against the negative effects of these problems. Thus the universities will be able to realize their goals more effectively and contribute to its social interest groups better. This contribution can also prevent many reactions in the public opinion and hazards that may arise from conjectural fluctuations.

# REFERENCES


Abas, Z. and Yaacob, Z. (2006), Exploring the Relationships between Total Quality Management (TQM), Strategic Control Systems (SCS) and Organizational Performance (OP) Using a SEM Framework, *The Journal of American Academy of Business*, Cambridge, Vol. 9, Num. 2, September, pp.161-166.

Aksoy, R. (2005), Zonguldak'ta Ayakta Tedavi Tüketicilerinin Sağlık Hizmeti Kalite Değerlemesi, *Zonguldak Karaelmas Üniversitesi Sosyal Bilimler Dergisi*, Cilt: 1, Sayı:1, pp.91-104.

Alpkan, L. (2000), Strateji Belirleme Sürecinin Kapsamlılığı, *Doğuş Üniversitesi Dergisi*, Sayı.2, Temmuz, pp.1-19.

Altunışık R., Coşkun, R., Bayraktaroğlu, S., Yıldırım, E., (2007), Sosyal Bilimlerde Araştırma Yöntemleri: SPSS Uygulamalı, Sakarya Yayıncılık, Sakarya, T.R.

Bumin, B. and Erkutlu, H. (2002), Toplam Kalite Yönetimi ve Kıyaslama (Benchmarking) İlişkileri, *Gazi Üniversitesi İ.İ.B.F. Dergisi*, pp.83-100.

Chen, J.K. and Chen, I.S., (2009), Performance Evaluatıon For The Bankıng Industry In Taıwan Based On Total Qualıty Management, *Global Journal of Business Research,* Vol. 3, No. 1, pp.49-60.

Dinçer, Ö. (2007), Stratejik Yönetim ve işletme Politikası, Alfa Yayınları, İstanbul, T.R.

Efil, İ., (2006), Toplam Kalite Yönetimi, Alfa Aktüel yayınları, Bursa, T.R.

Eren, E., (1990), İşletmelerde Stratejik Planlama ve Yönetim, İ.Ü. İşletme Fakültesi Yayınları 234, İstanbul, T.R.

Eren, E. (2005), Stratejik Yönetim ve İşletme Politikası, Beta Basım A.Ş., İstanbul, T.R.

Kıngır, S. (2007), Toplam Kalite ve Stratejik Yönetimde Yeni Eğilimler, Gazi Kitabevi, Ankara, T.R

Koçel, T., (2003), İşletme Yöneticiliği, Beta Basım Yayım dağıtım A.Ş., İstanbul, T.R.

Murat, G. and Bağdigen, M. (2008), Kamu İdarelerinde Stratejik Planlama ve Yönetim, Gazi Kitabevi, Ankara, T.R.

Nuroglu, E., and Nuroglu, H.H., (2008), Relationship Between Strategic Management And Total Quality Management How Can TQM be Implemented In The Service Sector Case Study: Vienna General Hospital, 4 th International Strategic Management Conference, June 19-21, 2008 Hollywood Hotel, Sarajevo, Bosnia-Herzegovina, pp.1029-1048.

Oliver, C. and Holzinger, I., (2008), The Effectıveness Of Strategıc Polıtıcal Management: A Dynamıc Capabılıtıes Framework, *Academy of Management Review,* Vol. 33, No. 2, pp.496–520.

Özer, M. A., (2008), 21. Yüzyılda Yönetim ve Yöneticiler, Nobel Yayın Dağıtım, Ankara, T.R.

Prasnikar, J., Debeljak, Z., Ahcan, A. (2005), Benchmarking as a Tool of Strategic Management Total Quality Management, Vol. 16, No. 2, March, pp.257–275.

Sadikoglu, E. and Zehir, C. (2008), The Impact of Contextual Factors on Total Qualıty Management Practıces, *4 th International Strategic Management Conference*, June 19-21, 2008 Hollywood Hotel, Sarajevo, Bosnia-Herzegovina, pp.1037-1048.

Sözer, A. N., Tütüncü, Ö., Doğan, İ. Ö. (2002), Dokuz Eylül Üniversitesi Sosyal Bilimler Enstitüsü'nde Lisansüstü Eğitim Kalitesinin Arttırılmasına Yönelik Bir Alan Araştırması, Dokuz Eylül Üniversitesi Sosyal Bilimler Enstitüsü Dergisi, Cilt 4, Sayı:2, pp. 41-65.

Şişman, T., (2002), Yüksek Öğretimde Toplam Kalite Yönetimi, *Standard Ekonomik ve Teknik Dergi,* Eylül

Ülgen, H., and Mirze, S. K., (2006), İşletmelerde Stratejik Yönetim, Literatür Yayınları, İstanbul, T.R.

Yang, C. C. (2008), Improving the definition and quantification of quality costs, Total Quality Management, Vol. 19, No. 3, March, pp.175–191.

http://www.sp.gov.tr/documents/SP-Kilavuz2.pdf; Access Date: 12.05.2009

# HOSPITALITY MANAGEMENT FROM A STRATEGIC PERSPECTIVE

**İge Pırnar**
**Dokuz Eylül University, Turkey**

**Ruhet Genc**
**Beykent University, Turkey**

## ABSTRACT

*Tourism is a global industry which has one of the worlds' highest growth rate among the other industries. It has an annual 4-5 % increase rate which brings high competition within the sector itself. Hospitality being the largest sub segment of this huge industry, brings requires specific managerial skills, training and strategic applications for the hospitality managers since the competition within the industry is very severe.*

*The study will cover specific conditions related to hospitality management, as well as specific characteristics required form a hotel manager in the theoretical perspective. Following literature review, the practical part will cover the applications. Qualitative research method will be conducted where the scope of the study will consist of 4 and 5 star hotels of the main tourism destinations.*

***Author Keywords:*** *hospitality management, hotel managers, strategic approach, hospitality trends, managerial skills*

## INTRODUCTION

Since tourism is a highly profitable industry with an important constant growth rate for the last thirty years, the competition among establishments is very severe. In order to stand out from this competition crowd and to appeal to their consumers with differential advantage, the hotel managers should possess specific managerial skills and specialized training on related concepts as well as having the ability keep up with constantly changing hospitality trends.

Hospitality management is specially complicated since it is a 24 hours a day non-stop service industry with its' customers having emotional buying behavior, preplanning about the purchase for long lead times causing hotel managers having the burn out effect almost7 times (Gee, 1994) more than other industries managers. They are also facing high stress levels and experiencing complexity in forecasting and decision making. Years of research on this topic indicates that hospitality management and hospitality managers should obtain specific requirements in addition to the ones needed for management in general.

## MANAGEMENT IN HOSPITALITY

Before dealing in detail with the managerial aspects of hospitality management, definition applying all fields to management should be covered. Management has been called by Mary Parker Follett "the art of getting things done through people" (Rees and Porter, 2008). In order to define it more properly, we may say that management is the process of planning, organizing, leading and controlling the work of organization members and of using all available organizational resources to reach stated organizational goals. In the same manner, a manager is the person who is in charge of an organization (hotel, restaurant, etc.) or of one or more of its subsidiary units (like food & beverage director, head housekeeper, etc.) Edward Wrapp indicates that "a good manager is the one, under competitive industry conditions, he is able to move his organization significantly toward the goals he has set, whether measured by higher return on investment, product improvement, development of management talent, faster growth in sales and earnings, or some other standard." His description of a manager covers the characteristics of a person who is not just trying to keep the stability or in other words status quo in a company but who has to follow up the changes and innovations constantly.

Actually, the last definition of a manager has the magic key word which is "change" in it. Process and improvement in each industry is dynamic which is especially true for hospitality. In hospitality the nature of the demand is constantly changing, so does the trends associated with it thus requiring creative action on the part of the many suppliers like hoteliers. (Goodall & Ashworth, 1988).

## Specific Considerations for International Hospitality Management

All hotel managers be it domestic or international, have to be able to fully utilize on universal management functions of: planning, organizing and staffing, coordinating, directing and communicating, controlling, evaluating, and representing in order to fulfill the needs of their job though this is not enough. While the functions sound the same, the way these functions are managed totally changes from one country to the other, one culture to the other. Thus the way to manage varies in different countries. The domestic hotel manager usually operates in a generally stable environment with a higher degree of predictability, which allows for better control over daily activities and forecasting; thus planning for the future. The international hotel manager, on the other hand, has to deal with many environmental uncertainties, and, no matter how well he or she has prepared and planned, faces many unpredictable crisis situations. In some countries, political and/or economic conditions change so rapidly that managers can only respond on a day-to-day basis, and their work is a constant challenge, requiring cultural insight, analytic skills, and the ability to adapt or to improvise according to the situation. (Gee, 1994).

Each hotel has its own organizational culture, own organizational climate thus shaped by hotel policies, guiding rules and excepted standards, and in true of the hotel's workforce. International (expatriate) managers must be prepared to act across cultural and national boundaries with respect to owners, staff, guests, suppliers, and others, whose values and attitudes might not fit their own prior references or experiences. At the same time, hospitality managers must manage by following the general principles that are set by the hotel company, which apply across the board. Cultural barriers in hospitality workplaces do exist, therefore it is important to understand ethnic diversity, cultures of minorities, and how to train ethnic groups in order to understand the various cultural aspects in the hospitality organization (Walker, 2004, s.532).

Hospitality managers operating in foreign environments must not only understand the similarities and differences in principles and practices of different cultural and geographic environments, but also be able to adapt to each situation according to cultural norms, power distance, and individual or group expectations of people in the host country. Hotel executives need to understand the boss and employee relationship pattern regarding the cultural environment hotel operates within. The power distance between leaders and staff and the amount of personal freedom allowed to individuals in different societies affect the way organizational relationships develop and how authority will be accepted. The culturally enlightened manager will adapt his or her leadership style to conform to the norms of the host environment to optimize organizational effectiveness and hotel productivity.

International guests have varying expectations, also, and their evaluation of a hotel and satisfaction level is effected by their own cultural perspectives and travel habits with respect to accommodations, amenities, food and beverages, service, and – most of all – hospitality style they receive. The concept of hospitality may be universal, but its application varies from culture to culture. In order to serve guests as individuals and not as "numbers", management and staff alike must understand what the various cultural ideas of hospitality are, and seek ways to provide for guests according to their needs or desires. Management should make sure that the staff is provided with proper training on different countries and cultures of hotel's target groups. There are at least six fundamental patterns of cultural differences that effect hospitality managers strategic applications. They may be stated as (Clarke and Chen, 2007):

- Different communication styles
- Different attitudes towards conflict and crisis
- Different approaches to completing tasks and time management

- Different decision-making styles
- Different attitudes towards admission
- Different approaches to knowledge management and technological applications

Besides cross-cultural communications and guest service considerations, there are other aspects of international hotel operations that require special knowledge. These may include accounting, purchasing, plant operations, hotel security, and legal provisions. In accounting, the various types of transactional and exchange rate exposures and the translation of foreign currencies on accounting statements can directly affect the hotel's cash flow and, ultimately, its profitability. In purchasing, a host country's import policies and regulations can complicate the procurement process. Since governments, as a rule, want to encourage local buying and local substitutions for imports, the hotel's management must attempt to work with local suppliers as much as possible.

Today the severe competition makes it necessary to apply market oriented strategic planning. Market-oriented strategic planning is the managerial process of developing and maintaining a feasible fit between the organization's objectives, skills and resources and its changing market opportunities (Kotler, Bowen and Makens, 2006). Strategic planning is a process that make sit possible for the organization to achieve its' pre-stated mission and goals (Kotler and Armstrong, 2001:47). Since word strategy is involved, it deals with long term planning (Evans, Campbell and Stonehouse, 2002). It is obvious that not just in the macro terms, but it micro level strategic plan application is necessary for long term success in changing environmental conditions.

Managing a hotel abroad requires taking into account many more factors which are uncertain and more variable. Flexibility, adaptability, and creativity seems to be required traits for any international hotel managers along with classic managerial skills that every manager should possess.

## Current Managerial Issues of the Hospitality Management: Keeping up with Changing Trends

Looking at the current situation in hospitality industry today, it is clear that it is complex and goes under constantly changing trends. There are also lots of management problems or misuse like; lack of planning, inefficient planning, relying only on short term planning, not dealing with yield management, such that if clearly observed there are countries with over-hotels, over-rooms (excess accommodation capacity) and some countries have deficiency of accommodation.

As experienced by many different countries hotel managers face politically volatile situations leading to guest safety and security concerns. These relate to legal concerns and the responsibility and duty of hotel managers to guests and the rights of guests. What may be legally binding in one country is not necessarily so in another. As security becomes a measure concern in tourism, it is a common sense to be prepared at crisis at all times though tourism managers are seldom trained or prepared to handle crises resulting from financial, terrorist, medical or political activities.

Another issue is related to changing customer preferences since the industry is constantly changing and so does lifestyles and guest preferences. Without the help of market research and planning, it is impossible to cope with these trends and shifts though form a strategic managerial approach they are not fully utilized in general. Since customer's lifestyles and AIO's (attitudes, interests and opinions) change market segmentation become an important concept which is a marketing strategy which divides the market into segments such that each segment has specific characteristics. But marketing (or merchandising) efforts are not enough in many organizations. (Lewis, Beggs, Shaw and Croffoot, 1986).

As John Canas (president of Dunfey Hotels) states the industry is very sensitive to economic conditions, like recession and inflation. Also, the industry is cyclical because just after when the business is good the construction of the new hotels starts and leads to hotel inflation. In addition, all uncontrollable factors like political, legal and social changes have their impacts on the industry. Due to global financial crisis that affects all the sectors, the hospitality has also started to get its' share. It is predicted that the consumers will get very price sensitive in 2009 and some of 2010. To respond to this sensitiveness, it is suggested that the tourism providers may use flexible rating systems like creating different rate groups as Rack Rate, Rack Rate less 10%, etc (Forrester, 2008), Another problem of the industry in almost all over the world is lack of qualified personnel which results from the inefficiency and unawareness in education. In addition, it is complicated to establish what managers do since manager's job vary greatly according to their setting, they have great flexibility in determining the contents and ways of their jobs and their behavior and the way to react to problems differ. Besides organization charts of many hotels do differ and there is no standardization.

As in every industry, technological developments are very common in hospitality like GDS, CRS and e-tourism applications. The hotel manager of today should be familiar with concepts of e-tourism, e-trade and global distribution and central reservation systems. The applications of existing and new technologies are rapidly increasing. like MIS usage on accounting, reservations, front office and inventory functions. Developments in technology are more user friendly and improve the applications of guest history and guest related information, kitchen planning, marketing and teleconferencing areas (Lewis, Beggs, Shaw, Croffoot, 1986). The use of Internet in travel-planning / booking by both business and leisure travelers seems to continue to grow but at a significantly lower rate than previous years (Yesawich, 2007). Direct on-line bookings by customers are predicted to make up a significant market share by 2010 with access available to most of the population in industrialized countries; “Virtual tourists” will have an increasing demand for multi-media travel information and Interactive TV and mobile devices will increasingly be used for the distribution of tourism products and services.

## Essentials of an Effective Hotel Manager

Hospitality industry has a "unique" nature within all service industries, therefore the requirements of its managers are somehow different than the other managers in other fields. In his study, Worsfold found that hotel managers were more assertive, venture some, independent, self-assured, extrovert, determined and imaginative when compared with general management norms (Worsfold, 1989). M.C. Shaner indicates that the most important values perceived by hospitality managers are honesty, responsibility and capability.

Another survey was dome by Stone among 140 UK general managers; 71 employed by hotel groups and 69 independent managers. The results indicated that when compared with other managers, the hotel managers tended to be more:

- calm, realistic and stable,

- assertive, competitive and stubborn,

- cheerful, active and enthusiastic,

- socially bold and spontaneous,

- realistic, independent and cynical,

harder to fool, more deliberate and concerned with self,

- concerned with practical matters and detail (Mullins & Davies, 1991).

Another study was conducted in China which covered 133 expatriate hotel managers as a sample to specify the selection criteria and required skills/areas of knowledge that are important to the success of them. The concerns and perceived causes of failure were also studied. The sample consisted managers from Singapore, Hong Kong, Malaysia, Philippines, Australia, Canada, USA, France and German. Managers' adaption skills, inter-personal skills, technical competence, and understanding of Chinese culture were found to be the most important selection criteria. Adjustment and adaptation skills, inter-personal relations skills, cultural stress management, knowledge of Chinese culture, and survival language are the most important skills for expatriates to master for success in China (Feng and Pearson, 2006).

Attributes of an effective travel and hospitality manager may be divided into three basic groups; as technical competence, social and human skills and conceptual ability. In addition to all the factors stated above predictors of managerial effectiveness can be developed in relation to he process of management, the products of management and especially the manager as a person (Worsfold, 1989).

Table 1 below indicates the probable success factors required for an international hotel manager. Though these factors are not the whole required, they are the main ones for an effective manager

### Table 1 Success Characteristics of the International Hotel Manager

| High Probability for Success | Low Probability for Success |
|---|---|
| Strong analytical skills | Inefficient technical ability |
| Good language skills | Weak language skills |
| Strong desire to work overseas | Unwilling to work overseas |
| Specific knowledge of various cultures | No knowledge on different cultures |
| Well-adjusted family situation | Family problems |
| Complete support of spouse | Low spouse support |
| Outer-going character | Inner oriented character |
| Creative thinking | Rigid thinking |
| Behavioral flexibility | Behavioral rigidity |
| Adaptability and open-mindedness | Rejection to adaptation – closed to new ideas |
| Strong communication skills (verbal and non verbal) | Weak communication skills (verbal and non verbal) |
| Good stress management skills | Weak stress management skills |
| Through knowledge on hotel trends | Little knowledge on trends |
| Through knowledge on hospitality strategic management and tools | Weak knowledge on hospitality strategic management and tools |

# Methodology

In this study, since social sciences are proved to be a confident field for qualitative research methods, interview technique is preferred. Another reason for this choice that researchers believed that they would obtain more detailed information with this method. The interviews were not structured The data gathered through qualitative techniques may be analyzed in various ways such as descriptive analysis and content analysis.

## Qualitative Research Method

There are many reasons for conducting qualitative research in this study. One reason is conviction of the researcher based upon experience. Another one is the nature of the problem. It can be used gain new ideas on topics which quite a bit of knowledge is already known. In contrast the research which is less quantitative such as social sciences is referred to as soft to underline the lack of dependability (Milliken, 2001: 71-77).

Today, the researchers claim that qualitative research may be certainly used in every field as well as in social sciences (Burton, 2007; Vaivio, 2008). Stainback and Stainback (1988) identified the "qualitative paradigm" as one where "reality changes with changes in people's perceptions"; where "reality is what people perceive it to be" and where "values will impact on the understanding the phenomena" (Lawrence and Ul-Haq, 1988:15-24).

In this study, since social sciences are proved to be a confident field for qualitative research methods, interview technique is preferred. The interviews were semi-structured and the population was consisted of 10 hotel managers of 5 star hotels in Aegean Region.

The data gathered through qualitative techniques may be analyzed in various ways such as descriptive analysis and content analysis. If requested the findings may be numerically summarized and the process lasts with reporting.

In this research the content analysis is used. The steps of the content analysis are summarized as following;

- Coding: The data gathered is coded by the researcher and there are various ways of coding such as;
    - Coding according to previously identified concepts,
    - Coding according to the concepts identified through the data being analyzed,

- Coding in a general framework.

In this research the second coding type is preferred since there is no previously defined conceptual structure guiding the analysis of the data.

- Definition of the theme: Coding and classifying the data should be supported with another step as defining general themes which collects the codes under specific categories and explains the data in general.
- Setting and Describing the Data According to the codes and themes.
- Commenting on the Findings.

## Content Analysis and Coding

Coding is done to the data which is gathered from each of the interviewees. The codes derived from the interviewees were defined under 3 broader topics. The broader themes that contain the codes are listed below;

- General definition of management and the role of the hotel manager in occupancy rates
- Necessary skills and characteristics of an effective hotel manager
- Success factors affecting hotel managers efforts

## Setting and Describing the Data According to the Codes and Themes

**General definition of management and the role of the hotel manager in occupancy rates**

Most of the interviewers agreed that the management function is about “getting things done through other people”. Though 4 of the respondents found this answer insufficient and added that the manager should also be the leader who by gathering data from related groups, partners and by and self-criticism should be able to reach the goals. Another interviewee stated that “getting things done is not enough without the managers team making and consultancy ability”. Another comment was that “the manager should lead to synergy like adding up the missing parts of puzzle”.

All of the respondents stated that top managerial level’s managerial skills in hospitality do help increase the occupancy rates of the hotels. Though it was indicated that lower level managers do have more impact on the occupancy rates since they are directly in relation with customers. One respondent stated that” though the top management levels’ impact the on occupancy rates is obvious, his or her team making ability do affect the hotels’ overall success and occupancy rates much more since the whole team is what makes the business go or fall”. Only one respondent indicated that “the hotel manager should have strategic talents and vision, in order to cope up with the ever changing trends in hospitality as well as dealing with economic and political global fluctuations”

**Necessary skills and characteristics of an effective hotel manager**

The necessary skills that a hotel manager should possess are briefly stated as; being creative, innovative, having planning skills, good in human relations having improved communication skills, having high IQ level as well as EQ level. Also, he or she should; be realistic, willing to work long hours, is able to work under stress, have knowledge on the target customers and market, be open-minded, have professional tourism education, be disciplined, determined, tolerant, patient, companionate and progressive.

In addition to the stated skills and personality traits, the hotel managers are expected to have team forming abilities, leadership traits, excessive coordination and communication skills and having intuition since service selling is harder than selling tangibles.

It is also found to be a harder job when compared with other industries’ managerial jobs, since it involves dealing with people at all times. In addition “having to deal with different cultures could be exhaustive” one respondent indicated.

**Success factors affecting hotel managers efforts**

The main success factors were stated as; being creative, open to changes, keeping up with trends, satisfying customers, emphasizing to quality and hygine in services, evaluating all the feedback 8both from staff and customers), serving with differential advantage, setting up a system that works flawlessly at all times. One respondent stated that “the success in hospitality management lies within the mall pieces and details”. Another stated that “the ratio of price and value and quality perceived is very important to guests and he hotel manager who can maintain a reasonable ratio for his or her guest is successful”.

The ethical issues and values of a hotel manager are also very important for satisfactory results. Most of the respondents indicated that the manager should have an honest character, and should care for environmental issues. Three respondents also stated that “a good hotel manager is the one who feels responsible for the society he or she works in”. One of the respondents mentioned that “it is very hard to depend on ethical values in sales department but it is easier to comply with them at other departments”. The honest approaches to guests are found to be the most important, since when guests feel that they are deceived (like having a cheap wine in expensive wine bottle or buying a hotel promotion that is misleading) the success of the management is negatively effected in the long run.

The last issue tried to figure out the managerial approaches of hotel managers to strategic methods, where only half of the respondents indicated that they are important though all the applicable strategies given as examples were on advertising, promotion and sales. Only one respondent mentioned using strategic methods in f&b and cost analyzing. He mentioned that “yield management techniques are especially useful in times of high competition and global crisis as today”. The other half of the respondents mentioned that they either have no idea on the strategy topic or they do not have time to apply such models and methods.

## Conclusion

The results of the study indicates that “creativity”, “keeping up with trends”, “having good communications skills”, “tolerance” and “willingness for hard-working” are very important traits for hotel managers. It is understood that managerial sills and the character of the manager itself, does have a positive or negative impact on the success of the hotel operation, staff motivation, guest satisfaction and occupancy rates. Since it is a people industry, the hotel managers should also have high EQ levels and outer oriented personalities. The through market and property knowledge were also found to be important indicators for success.

Ethical issues and knowledge and practice on strategic approaches were not found as important or useful as learned abilities and personality traits in hotel management. Thus it should be further investigated if this indifference occurs from the lack of knowledge, negligence, or any other reason.

It is also recommended to further analyze the topic with quantitative analysis methods and compare both methods for more healthier results.

## Appendix
## Interview Questions

1. Is management really “getting things done through other people”? Do you agree or not? Why?
2. What is the role of top management in the success of hotel’s success and occupancy rates?
3. What are the characteristics that a hotel manager should have? (according to you)
4. Do you believe that hotel managers should possess extra abilities and/or skills when compared with managers working in other industries? If yes, what are they?
5. Do you agree that hotel managers should work harder when compared with managers working in other industries?
6. State the issues of hotels’ success factors that the hotel manager should emphasize on.
7. What ethical principles or values do you think that the hotel manager should follow?
8. Do you agree that the management should give importance to strategic applications for his/her hotel’s success?

## References

Clarke A and W. Chen (2007), International Hospitality Management, Butterworth-Heinemann, pp.32

Davis, D.J. (1990), " Demographic change: the role of the hospitality manager", International Journal of Contemporary Hospitality Management, Vol. 2 No.2, pp.33-5.

Evans N., Campbell D. and Stonehouse G., (2002), Strategic Management for Travel and Tourism, Butterworth Heınemann.

Feng F. and Pearson, T. E. (1995), “Hotel Expatriate Managers in China: Selection Criteria, Important Skills And Knowledge, Repatriation Concerns, And Causes Of Failure”, International Journal of Hospitality Management: 7 1 (1995), pp. 3–6.

Forrester M., “Online hotel marketing tips for a recession”, December 18, 2008, Hotelmarketing.com, available in: http://www.hotelmarketing.com/index.php/content/article/online_hotel_marketing_tips_for_a_recession/, accessed at: 20 December 2008.

Gamble & Messenger, "Preparing managers for Industry", Journal of Management Development in Hospitality and Tourism, pp.13-19.

Gee C. (1994), International Hotel management, Educational ınstitute of AHMA, Michigan, USA.

Goodall B. and Assworht G.J. (1988) Marketing In the Tourism Industry.

Haywood, K.M., "Managing Technology", Cornell HRA Quarterly, May 1990, p.40

Kotler P. and G. Armstrong (2001), Principles of Marketing, 9th edition, Prentice-Hall, New Jersey.

Kotler P., John B. and James M. (2006), Marketing For Hospitality And Tourism, 4th Edition, Prentice, Hall, New Jersey

Lawrence, P. and Ul-Haq, R. (1998). Qualitative Research into Strategic Alliances. Qualitative Market Research: An International Journal. Volume 1 , Number 1.

Lewis, Beggs, Shaw & Croffoot (1986), The Practice of Hospitality Management II, AVI, pp. 4, 13, 191.

Milliken, J. (2001). Qualitative Research and Marketing Management. Management Decision. Vol: 39/1. pp.71-77.

Mullins and Davies (1991), "What Makes for an Effective Hotel Manager?", International Journal of Contemporary Hospitality Management, Vol. 3, No.1. pp.22-25

Mullins J. L. (2001), Hospitality Management and Organisational Behaviour, 4th edition, Longman.

Pırnar I (2005) "Turizm İşletmelerinde Etkin Yönetim ve Çağdaş Pazarlama", İşletme ve Finans Dergisi, Ekim 2005, 235: 62-76, Ankara, www.isletme-finans.com.

Rees W D..and Porter C. (2008), The re-branding of management development as leadership development – and its dangers, Industrial and Commercial Training, Year: 2008
Volume: 40, Issue: 5, Page: 242 – 247

Stainback, S. and Stainback, W. (1988), Understanding and Conducting Qualitative Research. Kendall-Hunt. Dubuque, IA.
Vaivio, J. (2008). Qualitative Management Accounting Research: Rationale, Pitfalls and Potential. Qualitative Research in Accounting & Management; Volume: 5 Issue: 1.

Walker, J. R. (2004) Introduction to Hospitality Management, New Jersey: Pearson Education Inc., Upper Saddle River.

Worsfold, P. (1989), "A Personality Profile of the Hotel Manager", International Journal of Hospitality Management, Vol.8, No.1, 1989, pp.51-62.

Yesawich P., Yesawich, P., Brown & Russell Company, “Trends to Watch in 2007”, 19th January 2007, available at: www.hotelmarketing.com/index.php/content/article/070118_ten_travel_trends_to_watch_in_2007, accessed at: 19 December 2008.

# *STRATEGIC MARKETING*

# THE MARKETING & INSTRUMENT STUDY OF DEVELOPMENT OF A COMPANY'S COMPETITIVE TACTICS IN THE TURBULENT MARKET OF THE MOBILE COMMUNICATION SERVICES

**I. Mostovaya,**
**N. Muravyova,**
**M. Yasko**
**Southern Federal University, Russia**

## ABSTRACT

*During the decision-making process about a market position, the measure of uncertainty depends on a degree of authenticity and completeness of the information; therefore it is necessary to do a marketing research to determine a company's position, to make strategic aims and long-term guidelines in accordance with a development of technologies, changes of macroeconomic, political y socio-cultural factors; on the background of these factors, the operating companies build the relationships with all participants of a services market of mobile communication. The research was held by means of an adaptation of general technical approaches to a real analysis of regional services market of mobile communication; this research helps to form an authentic information about market condition, that is: to know about market share, which belongs to a company-operator; to form stable preferences of the buyers, to determine individual market position of the operating company; the research affords to motivate the competitive advantage of the operating company, to develop and to realize the growth strategies of the competitiveness.*

## INTRODUCTION

The hypothesis of the study is based on the relative existence of the positive connection between the complex study of the market of the mobile communication services , the clear identification of a company's market position - which is influenced by the unstable environment – and the efficacy of the marketing strategy in conditions of the highly competitive market.

The telecommunications market of Russia is an important part of the aggregate market of the communication services and is characterized as a complex organizational, economical and jurisdictional structure with a strict order of functioning of its elements. In the structure of this market there can be specified the following criteria: the local market, the regional market, the national market and the world market.

The following subjects are currently operating within the telecommunications market in Russia:

- The traditional operators of mobile communication – companies based on the governmental enterprises which have been privatized and reorganized;
- The new operators of mobile communication – companies licensed after 1990;
- The other enterprises in different sectors of economy offering services of mobile communication.

The federal companies-operators tend to use quite aggressive methods of marketing due to their big expenses on the image making and on the advertising; introducing a new promotional campaign into the market – which usually happens on the federal level – involves federal TV-channels, radio stations, local TV-channels and other means so that the consumers get the idea of numerous advantages of the given federal operator.

The regional operators considerably cede to the federal ones in terms of resources (technical, financial etc); however, they are capable of reacting quickly and flexibly to the concurrent actions. The fact that the management of a regional company is not separated from its basic activities allows getting hold of the current situation of the market and making timely decisions; also this adaptability of regional operators enables them to thoroughly investigate the market and to find the most specific target market, aiming at these customers the most suitable offers and packages of services.

Speaking of the elasticity of the regional market and its potential, there are two main characteristics that make an impact on the elasticity of demand: the cost of the contract with the operator and the cost of a one-minute talk. In a long-term perspective the regional companies are not likely to compete successfully with the federal operators that benefit from the effect of scale and of synergy. For a shorter period of time, there is a possibility of occupying a targeted segment of market and even of competing with federal companies in the regions where local operators are strong enough for it. Uniting under one brand several operators from the same region, controlling expenses while expanding the territory of roaming, concentrating efforts on concrete segments of the market and other measures can stabilize the situation to a certain extent.

Researching the peculiarities of the mobile operators' market demonstrated that the relevant companies tend to use a common system of technical standards; new types of services keep being introduced into the market.

**Functional & marketing fields of activity of mobile operators**

| **Fields of activity** | **Characteristic** |
|---|---|
| Providing a subscriber with an individual telephone number | The connection of a given telephone number with a united system, which is a structure of national and global scale. |
| Assurance of cellular communication's work | Cellular network unites a lot of base stations; each of the stations provides the connection on definite territory and guarantees mobile communication to all subscribers of this operator in the service area of the given station (of course, the base station can provide simultaneously a big quantity of subscribers with a mobile communication, but the quantity is limited). Base stations are connected with the united structure by the telecommunication channels (both cable and wireless cable). Besides the base stations, cellular network includes a whole number of other communication centers with a hardware and software support. |
| Roaming | Possibility to use a mobile phone outside of the "domestic area" without using services of any second cellular communication operator. |
| | To provide roaming, the operating company uses not only it's own technologies, but the resources of other communication companies: both cellular communication operators and operators providing interurban/international channels. For the efficient use of all necessary resources, a big preparatory work should be done, for example: to make the contracts with companies from other regions of the World, adjustment of a billing system. |
| Providing a subscriber with the additional facilities. | Communication facilities (sms, mms), information services (sms-sending, Internet access); service facilities (number identifier); entertaining facilities. |
| Function of a Single Calculation (Billing) Centre | Sending to the subscriber's address of the invoices from different companies providing communication facilities (for example, long-distance telephony), other facilities (games and tunes). |

The specifics of using different methods of the marketing research are caused by the peculiarities of the product (in the market of telecommunications) and by the character of consumers' behavior; both aspects should be considered when organizing the routine of a company-operator and also during the realization of the marketing concept.

Currently the most popular method of the marketing research for the market of telecommunications consists in questioning the customers (interviews in the stores or via telephone or Internet, polls, surveys etc). The quality of the results obtained through methods listed above depends on transparency and precision of the questions and on experience of the interviewer who should react flexibly to the customer's responses.

At the present time, within the telecommunications market of the Rostov region the most important brands are: "MegaFon", "BeeLine GSM", "MTS." Among these federal operators there are several local operators, for example, the company "Rostov Mobile Connection" ("ROSS"). The company was founded in 1993 by a foreign company and specializes in cellular network services. In November 2001, the company changed its trademark by entering the European holding company TELE2 AB (Sweden, Stockholm). Holding TELE 2 was established in 1993 in Sweden. In Russia, the services of Tele 2 are presented not in the Rostov region, but also in Belgorod, Irkutsk, Kemerovo, Kursk, Nizhny Novgorod, Omsk, Smolensk, Chelyabinsk region, as well as in the republic Udmurtiya, St. Petersburg and Leningrad region.

Analysis of the positions of the mobile operator TELE2 allows to determine the main directions of its activities, the aims and objectives of the company within the highly competitive telecommunications market.

The competitiveness of the company-operator depends on the overall efficiency of its operations, the use of modern technology management and marketing, quality of service and marketing activities of a number of other economic and technical parameters of the company. The model of competitive forces in relation to the company operator TELE2 is a powerful tool in the systematic diagnosis of the main factors influencing the market, and for the definition of the impact of each of them. Study of this model is a prerequisite for the formation of systemic vision of competition operating company.

Measurement and analysis of the strategic environment has been made using the adapted for «Rostov Mobile Connection» expert method. Tool to measure the strategic environment was a «scale relations». Evaluation of components and parameters of the environment are carried out on 5-point scale. Assessment of the strategic environment is presented in appendix 1.

To determine the strategy of the organization and conduct of this strategy, the direction of JSC «ROSS» must have an in-depth presentation of both the internal environment of the organization, its capabilities and trends, and the external environment, trends in its development and place of its organization. This internal environment is studied in order to reveal the strengths and weaknesses of the company's mobile phone operator, and the external environment is studied in the first instance in order to expose the threats and opportunities that an organization should consider when determining your marketing goals and to achieve them.

In order to identify strengths and weaknesses of the organization, the organization needs know its strategic potential.

Measuring the strategic capabilities is effected using questionnaires where the experts put their assessments on a 5-point scale. Assessment of the strategic capacity of CJSC «ROSS» TELE2 is presented in appendix 2.

Through the analysis of strategic capabilities, a specific list identified weaknesses and strengths of the organization, as well as threats and opportunities.

Applying the method of SWOT, it's possible to create links between the strengths and weaknesses that are inherent in the organization.

Identification of the chain links allows to clarify the direction of the development of the company «ROSS»: the expansion of coverage, cost reduction, sustainable provision of services, development of new types of services, skills development, improving the quality of services, opening new service centers, the introduction of modern technology in the management, improving the organizational culture.

To determine the strategic position the experts used the method of approximate calculation. According to this method, the strategic position of the organization may be determined by the extent of development of the strategy, by market conditions and industry conditions.

To the executive managers of the company it was proposed to assess the activity of the company. The results of the strategic environment of the situation are presented in appendix 3 (on 9-point scale).

According to these estimates and using the field of strategic positions (model Yefremova VS) it can be concluded that the JSC «ROSS» has the position of «Candidate for Master» in the field of competitive policy positions.

Strategic position for JSC «ROSS» is defined as «a candidate for the master». This position is distinguished by the fact that the organization has an excellent micro and macro conditions to conduct their business.

However, the market and the industry conditions of business for the organization are far from good. Adverse market conditions for the organization may be related to the fact that it had not yet received a fair share of the market, or has lost its essential part. This may be due to the fact that market segment of the given organization has not been formed completely yet. Unfavorable industry conditions of the market have been caused by severe competition. Therefore “ROSS” should focus primarily on opposition to competition and is aimed to increase their profit margins through increased productivity. The company has all the necessary internal and external conditions for this.

Present position «Candidate for Master» means that the company carries on its business in an attractive industry and has significant competitive advantages. The strategic potential of the company is able to counter the negative factors of the environment, to reinvest earnings and to maximize profits.

CJSC «ROSS» has the ability to implement strategies to capture the market and for direct and reverse integration; however, given the unique position, it is necessary to apply the strategy of concentric diversification.

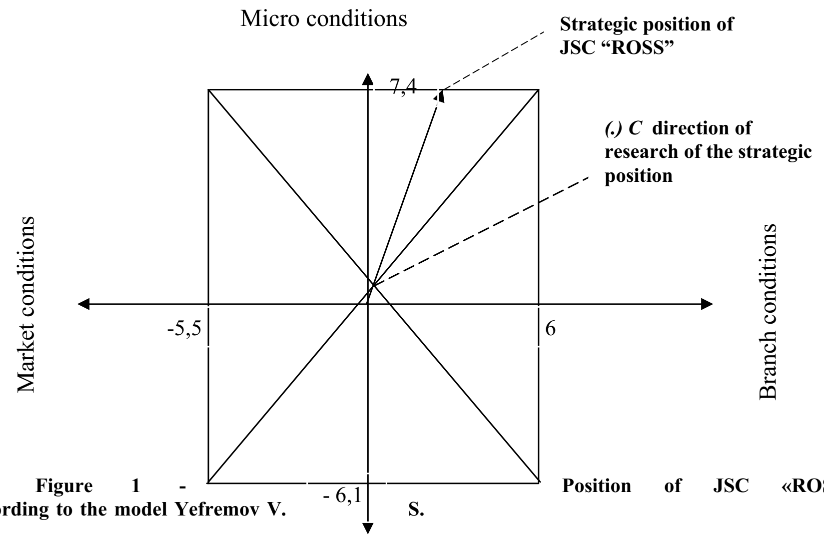



**Figure 1 - Position of JSC «ROSS» according to the model Yefremov V. S.**

# LITERATURE REVIEW

Theory and practice of marketing and marketing research are reflected in the scientific work of foreign researchers, representatives of various schools and directions, which substantiated the need for market orientation of the subjects on the principles of marketing, made it and discovered the possibility of using for different types of firms in different markets.

Thus, the analytical model developed by Ansoff (1965) provided the opportunity to realize the process of making strategic decisions, and the approach of Andrews, K. (1971), based on the logic of the method of SWOT, allowed managers to conduct an analysis of internal and external environment company and to build a strategy for particular situation. The dominant paradigm in the theory of marketing was a concept developed by M. Porter competitive forces (1980), which provides a systematic way of thinking about how the competitive forces operating in the industry, the extent to which the pre-level profitability of businesses in different industries and segments. Day J. (1999) gave arguments in favor of the concept of marketing that focuses on services, «focused» on the client and focus on the market. According to this concept, the company is in the process of continuously generating and testing hypotheses about the market. He conducted an analysis (2004) of the role of marketing research and its contribution to the management process. Lamben (2004) considered the market research, as a function serving the information needs of management in general, not only in marketing.

Russian marketing researchers tend to study problems of adaptation of methods of marketing research to the specifics of modern Russian enterprises.

Thus, the basic concepts and methods of marketing research reviewed in the works of Tarasevitch V. M. (2001), Bozhuk S. G. (2005), Kovalik L. N., Maslova T. D., Golubkova E. P. (2004).

In the writings of scholars Rostov school: Anopchenko T.Yu. , B. B. Borisova, V. G. Ignatov, Ketova N. P., Kostoglodova D., Kuznetsova N. G., Simonyan T. V., Fedko V. P., Fedko N. G., there are aspects of marketing research, market opportunities and of the development and implementing strategies to improve the competitiveness of companies in the market.

Features of the development of telecommunications markets covered in the works Golubitsky EA, Kukharenko EG (2005), Razroeva EA (1999), Reznikova NP (2002).

Thus, domestic and foreign researchers of problems of marketing generally formed the theoretical interpretation and identified areas for exploring markets for services. However, the contradictory character of the problems, lack of developed methodological approaches to marketing research of the market of mobile services make it relevant and determine the purpose and objectives of the study.

# METHODOLOGY

As a theoretical and methodological basis of the research were used: fundamental basics of the theory of marketing as a social and economic process, the theory of marketing research, as well as the theory of strategic management and marketing, and others presented in the scientific literature. The use of these provisions as a source to justify the author's version led to its advantages, deterministic effect of complementarities of different scientific approaches.

The development of problem used instrument and methodological tools, including systematic approach to its subject-object and functional-structural aspects, methods and tools of technology research. Each of these private methods used as the primary, supplementary or test in accordance with its functionality and resolution. In addition, were used special tools for market research, including SWOT-analysis STEP analysis, special receptions desk and field market research: the method of expert evaluations, positioning technology company.

# CONCLUSION

Marketing research allows to build an accurate data basis about the market and is the initial phase of marketing activity. Based on the obtained in the process of research results, the following conclusions can be made.

Study in the investigation of the market for mobile communication services, where conduct their business both federal and regional business operators, showed that companies operating in this market, in practice apply a unified system of technical standards, which provides interaction networks management systems.
The competitiveness of the company-operator depends on the overall efficiency of its operations, the use of modern technology management and marketing, quality of service and marketing activities of a number of other economic and technical parameters of the company. The study defined the position and prospects of the company TELE2 through the analysis of internal and external environment, which allows organizations to identify their threats and opportunities, their strengths and weaknesses. These results are used in the SWOT-analysis to identify areas for development of mobile communications.
Based on the analysis of external and internal environment of proposed options strategies to enhance the competitiveness of the company.

# REFERENCES

[i] Muravyova N.N. Role of the marketing researches in a formation of an authentic information about the market//
Economic bulletin of the Rostov State University. SEI HPE “RSU”, 2006. No.4.
[ii] http//www.minsvyaz.ru.
[iii] Prepared by the author
[iv] Golubitskaya E.A., Kukharenko E.G., Fundamentals of the Marketing in telecommunications – M.: Radio and communication, 2005
[v] Dibb S., Simkin L., Pride W., Ferrel O. Marketing: Concepts and strategies. Boston: Houghton Mifflin. 1994;
Deyan A. Study of the market/ Translated from French. Ed. S.G. Bozhuk.- St. Petersburg: “Neva”, 2003. Pages 27-38.
[vi] Prepared by the author according to the materials of Porter M. Competition. Translated from the English – M.: Publishing House “Williams”, 2000.; Popova S.A. Strategic management: Program of 17 segments for managers. “Management of the company’s development”. Segment 4. M.: Infra-M.1999.


# APPENDIX 1

| № | Components of the blocks<br>The scale of opportunuties | Threats<br>1 2 | <br>3 | Opportunuties<br>4 5 |
|---|---|---|---|---|
| 1. Evaluation of strategic macro climate (STEP - an analysis of the strategic areas) | | | | |
| 1.1 | Social, environmental, geographic sphere and the sphere of communication. | | 3 | |
| 1.2 | Technological and scientific sphere. | | | 5 |
| 1.3 | Economical and financial sphere. | | 3 | |
| 1.4 | Political and legal sphere. | | | 4 |
| Final assessment of the strategic macro climate 3.75 | | | | |
| 2. Assessment of the strategic micro climate (analysis of the strategical areas) | | | | |
| 2.1 | The area, the market segment: the level of competition, relationships with partners and customers | | | 4 |
| 2.2 | The area of investment | | | 4 |
| 2.3 | The area of new technologies and of scientific and technical resourses | | | 4 |
| 2.4 | The zone of raw materials, fuel, energetical resourses | | | 4 |
| 2.5 | The area of the labor resourses | | | 4 |
| 2.6 | The groups of strategic influence (at the level of an industry, of a city, of a region etc) | | | 4 |
| The final assessment of the strategic microclimate 4 | | | | |
| Total | | | | |
| 1 | Evaluation of the macro climate | | | 3.75 |
| 2 | Evaluation of the micro climate | | | 4 |
| **The final assessment of the strategic environment 3.9** | | | | |
| | | | | |

# APPENDIX 2

**The assessment of the strategic potential of “ROSS”**

| № | Components of the blocks | The state of the customer company | | |
|---|---|---|---|---|
| | | Strengths | | Weaknesses |
| 1. Product unit (assessment of quality, of profitability and of the volume of sales of the product, the status of resourse maintenance and of performance of the functions) | | | | |
| 1.1 | Condition of the project № 1 | 4 | | |
| 1.2 | Condition of the project № 2 | 4 | | |
| Final assessment of the product unit | | | | |
| 2. Functional unit | | | | |
| 2.1 | R&D, pilot and test works | | 3 | |
| 2.2 | Manufacturing: basic and auxiliary | | 3 | |
| 2.3 | Marketing and sales | 4 | | |
| 2.4 | Services for customers | 4 | | |
| 2.5 | Finance | 4 | | |
| 2.6 | Administration | 5 | | |
| 2.7 | Staff | 5 | | |
| Final assessment of the functional unit – 4 | | | | |
| 3. Resourses unit | | | | |
| 3.1 | Material and technical resourses | | | |
| 1) | raw materials, fuel and energy | 4 | | |
| 2) | components | 4 | | |
| 3) | equipment and machinery, communication and transportation | | 3 | |
| Final assessment of the material and technical resourses - 3,6 | | | | |
| 3.2 | Labor resourses | | | |
| 1) | Composition and competence of managers | 5 | | |
| 2) | Composition and competence of professionals | 4 | | |
| 3) | Composition and competence of workers | 4 | | |
| Final assessment of the labor resourses – 4,3 | | | | |
| 3.3 | Informational resourses | | | |
| 1) | Scientific and technological advance, patents and «know-how» | | 3 | |
| 2) | Economic data | 4 | | |
| 3) | Commercial information | 4 | | |
| Final assessment of the informational resourses – 3,6 | | | | |
| 3.4 | Financial resourses | | | |
| 1) | Possibility of financing from own resourses | | 3 | |
| 2) | The availability of working capital | 4 | | |
| 3) | The availability of funding for salaries | 5 | | |
| Final assessment of the financial resourses – 4 | | | | |
| Total | | | | |
| 3.1 | Condition of material and technical resourses | 3.6 | | |
| 3.2 | Condition of the labor force | 4.3 | | |
| 3.3 | Condition of informational resourses | 3.6 | | |
| 3.4 | Condition of financial resourses | 4 | | |
| Total assessment of resourses – 3,9 | | | | |
| 4. Organizational unit | | | | |
| 4.1 | Organizational structure | | | |
| 1) | Configuration | 4 | | |
| 2) | Function: composition and quality of the division of labor | 5 | | |
| 3) | Quality of internal and external, vertical and horizontal links | 4 | | |
| 4) | Relations: rights and responsibilities | | 3 | |
| Final assessment of the organizational unit - 4 | | | | |
| 4.2 | Technology of all the processes | | | |

| | | | | |
|---|---|---|---|---|
| 1)<br>2) | Progress of current technologies and methods<br>Level of automation | <br>5 | 3 | |
| Final assessment of the level of technology - 4 | | | | |
| 4.3 | Organizational culture | | | |
| 1)<br>2)<br>3) | Communicational system<br>Tradition, experience and faith in opportunuties<br>Work ethic and motivation | 4<br>4<br>4 | | |
| Final assessment of organizational culture - 4 | | | | |
| Total | | | | |
| 4.1<br>4.2<br>4.3 | Organizational Structure<br>Technology of processes<br>Organizational culture | 4<br>4<br>4 | | |
| Final assessment of the organizational unit - 4 | | | | |
| 5. Management unit | | | | |
| 5.1<br>5.2<br><br>5.3 | Overall, functional and project management<br>System of management: planning, organizing, monitoring, motivation, coordination<br>Style of management (a combination of autonomy and centralization) | 4<br><br><br>4 | <br>3 | |
| Final assessment of the unit of management- 3.6 | | | | |
| Total for the units of strategic capacity | | | | |
| 1<br>2<br>3<br>4<br>5 | Condition of the product unit<br>Condition of the functional unit<br>Condition of the resourses unit<br>Condition of the organizational unit<br>Condition of the unit of management | 4<br>4<br>3.9<br>4<br>3.6 | | |
| Final assessment of the strategic capacity - 3.9 | | | | |

# APPENDIX 3

**Assessments of the strategic conditions of the company's position**

| | |
|---|---|
| *Market conditions.*<br>Assessment of the capacity of market - 7<br>Assessment of the structure of the market - 4,5<br>Assessment of the age of the market -3<br>Assessment of the elasticity of demand -5<br>Evaluation of the key factors of success - 8<br>***Total evaluation of the market 5,5*** | *Sectoral conditions.*<br>**Assessment of the structure and dynamics of competition in the industry -4**<br>Assessment of the threat of potential competitors - 4<br>Assessment of depending on the customers - 5<br>Assessment of depending on suppliers - 8<br>Evaluation of pressure of the producers of subsitute goods - 9<br>***Total evaluation of the conditions of the industry - 6*** |
| *Macro conditions.*<br>Assessment of the political environment - 6<br>Assessment of the economical environment -5,5<br>Assessment of the state of society -6<br>Assessment of the technological conditions -7<br>Total assessment of the macro conditions - 6,1 | *Micro conditions.*<br>**Evaluation of the industrial and and technological system - 7,5**<br>Assessment of financial and economic system – 7,5<br>Assessment of management - 7<br>Evaluation of the pre-production stage and of the marketing - 8,5<br>Assessment of the corporate culture – 6,5<br>Total evaluation of the micro conditions - 7,4 |

# THE IMPACT OF TECHNOLOGY ON COMPETITIVE MARKETING BY BANKS: A CASE OF STANDARD BANK IN KING-WILLIAMS TOWN, EASTERN CAPE PROVINCE, SOUTH AFRICA.

**Reginald Masocha**
**University of Fort Hare, South Africa**
**Norman Chiliya**
**Monash University, South Africa**
**Stanislous Zindiye**
**Rhodes University, South Africa**

## ABSTRACT

*Traditionally banks were not expected to struggle with strategies for attaining profitability, since enough profits would be made from the then readily available customers. Today, banking customers are now global tyrants; they represent and possess the power of international connectivity as they are increasingly anticipated to foster business with firms in other countries resulting in them seldom acquiring banking services from banks in their countries alone. This study is a fairly new research initiative endeavouring to examine and discuss the extent of technological utilisation in various competitive marketing practices of a financial institution in today's inexcusable 21st century competitive business environments. On this backdrop, the study investigated the impact of technology on competitive marketing by Standard Bank in King-Williams Town, Eastern Cape Province, South Africa.Quantitative research techniques were utilised to obtain customer and employees perceptions, opinions and experiences in e-banking services. To empirically investigate the research problem the study primarily hypothesised that the use of modern banking technology significantly impacted service delivery to clients. The study established that the access to ATMs should be improved thereby requiring upholding of education on ATM usage since business transactions are occurring 24 hours, and these can only be possible if there is a supportive banking network during the 24 hours. The empirical results consistently support general competition trends occurring in the banking industry in South Africa and worldwide due to technological marketing. The results reflect an extensive prioritisation of e-banking but, however generally low usage levels of the recently developed banking technologies by customers. Practically, the study informs firms, particularly financial institutions on the key technology implications and manipulations of their value offerings from the South African milieu.*

***Keywords: Technological marketing, heightened competition, e-banking, service delivery***

## INTRODUCTION

The rampant tempo of technological revolutions demands that investigations on implications of technology in marketplaces be intensified. Amidst these transcending technology transformations across the markets, banks in particular, have been greatly reconsidering their marketing strategies. The concept of technological marketing is therefore inevitably proliferated in the new economy (Fang Wang 2004:3), and vividly abounds a large part of the contemporary marketing practices as firms strive for superiority in the face of extreme competitive environments (Zineldin, 2000; Wai-Ching, 2008; Brady *et al.,* 2008; Durkin & Howcroft, 2003; and Fang Wang, 2004). Conspicuously, the financial sector has continuously embraced heightening competition, globalisation and incessant technological developments, consequently spurring an increase of links and networks within the industry (Durkin & Howcroft, 2003:61). The digitalisation pervasiveness coupled with the internet as a major role player, poise information to be the new medium of exchange in markets and not just money (Hollensen, 2003:495). Abratt & Russell, (1999) highlight that unlike the olden days' where bankers' selection of banks was primarily influenced by rates, fees and prices charged, competition amongst banks has shifted towards service excellence, streamlined services and (above all) innovative products. Motivated by this ubiquity and vitality of technological competence as a contemporary business and marketing practice across industries and within firms, the paper comprehensively delineates technological marketing regarded as a new concept in the marketing fraternity, *per se*.

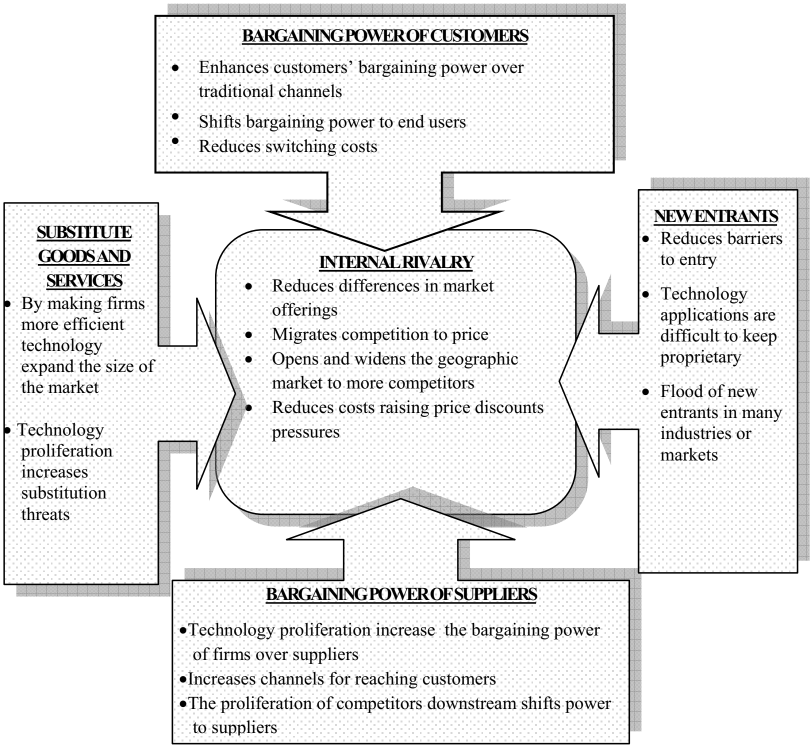
# LITERATURE REVIEW

## Technological Marketing

Continuous technological advances in the external and internal business environments has pressured firms to prioritise new technological innovation, subsequently bringing into sharper focus the profiles of targeted market segments (Reedy & Schullo, 2004:1). In the face of the twenty first century economy, marketing practices changes ideally to take advantage of the new technologies. Managers are compelled to respond to the risk and challenges of failure by appreciating and acknowledging the dangers of technological deficiency in line with competition in their respective industries (de Klerk & Kroon, 2005). The logic and consistency of the marketing process, namely: situation analysis, marketing planning, and strategy implementation and control are firmly endorsed in modern marketing technologies. Constant innovation is necessary to improve the marketing strategies and processes, to maximise the delivery of customer benefits and satisfaction (Reedy & Schullo, 2004:5). Competition stemming from advanced technologies creates complex decision-making situations for managers in the banking sector and organisations nationally and globally. Digital computing, data storage, and the ability to transmit digital signals through telecommunication networks will give firms an interactive marketing strategy which combines product features, product development, pricing, and customer information. Businesses in the 21st century are expected to respond quickly to customer demands. Through technology, flexibility is increased and firms are able to attract customers and efficiently respond to their demands (Lamb *et al.*, 2002:637). Marketers can choose to take advantage of one or more of the economic benefits and opportunities offered by new technologies. If incorrectly applied, however, they could raise complex ethical issues and also present significant threats (Walker *et al.,* 2006:264).
Technological Markets
***Technology is crumbling and bringing together markets to the extent that similar firms, with similar products and brands, are being found in proximal markets. In other words there is no clear divisibility and exclusivity of markets globally and nationally which used to exist in the olden days business environments. Firms in any industry face at least five sources of competition as they compete for higher profitability in serving customers (Hellriegel,*** **et al.,** ***2004:104). Grewal*** **et al.,** ***(2001:18) indicate that electronic markets relate to IT mediated markets where buyers and sellers collaborate in a marketspace and exchange information regarding products, product specifications and terms of trade. Accessibility of markets has been exacerbated by the rapid growth of technology, resulting in hyper-competitive environments. Michael Porter's five Competitive forces model aids the description and assessment of the competitive structure of the banking sector with special attention on King-Williams Town. Boone & Kurtz (1992:44) assert that firms need to constantly monitor these factors since the integrated impact of these forces determines greatly the firm's potential of attaining profitability within a market. Fig 1 below depicts the Porter's new model. The discussion below summarises how technology can influence the market using the task environment, thus, the five competitive forces (Hellriegel,*** **et al.,** ***2004:104).***

*Rivalry from Existing Firms.* When a market is composed of numerous and almost balanced competing firms, overall competition in the industry intensifies. Prominently, competitors will utilise strategies such as price-cutting, improved service deliverance and quality (Hellriegel *et al.*, 2004:104). Focusing and specialising on the firm's internal activities as well as its competitors' strategies is crucial in winning today's competition. Irreplaceably, market competition intensifies when strategies by major competitors are combined with technological advancements in production and product offerings. Thus, heightened competition in the financial sector is undeniably being proliferated by a dynamic interplay in massive technological use by banks (Malcolm & Martin, 2003:96). Technology is viewed by many as a bank's principal vehicle for reducing its high-cost 'bricks and mortar' infrastructure.

## FIG 1: TECHNOLOGICAL COMPETITIVENESS OF MARKETS




***Source: Porter, 2001:67***

***As a result banks constantly search for new developments or better ways of operating their businesses. As of now, considerable trends are emerging that are aptly to gain impetus in the banking industries. For instance, as part and parcel of the improved thrust into retail banking, the banks are almost certainly introducing new and more user-friendly technology. As competition for personal business intensifies, profit margins are shrinking thereby forcing banks to shift towards low-cost electronic transactions for continued earnings growth (Padgett & Mulvey, 2007:375-376; Durkin & Howcroft, 2003:63).***

**Threat of Substitute Goods/Services.** ***Competition increases when high quality substitutes exist in ample quantities and at competitive or comparable prices (Stevens* et al.*, 2006:115). New technologies result in new goods and services for consumers, improved existing products, better customer services, and often lower prices. This is as a result of the development of more cost-efficient production and distribution methods (Boone & Kurtz, 1992:56). Rapid growth in technologies particularly the internet, and other faster communication and transport methods have improved the speed of business (Kotler & Keller, 2006:13). Banks generally need to appreciate that competition is no longer on the physical places but on a computer-mediated environment (Hollensen, 2003:395).Industry margins are continuously blurring, while channel disintermediation is increasing and the net result is that products and services become tradable inter-industries. In fact, in the financial sector technology has widened the platform at which financial institutions should compete on, since the substitutability of financial services has been increased. When assessing substitute services should not only focus on other banks such as ABSA, Nedbank, FNB, and CAPITEC only. It has to also consider firms which are also providing services and products substituting the banking services e.g. supermarkets, insurance companies, the post office and even football clubs (Falkena,* et al.*, 2004)***

*Threat of New Entrants.* In many industries competition increases when it develops from outside the traditional industry. New entrants enter the market prepared to challenge the incumbents with new methods of conducting business. Incumbents might find it difficult to develop sustainable competitive strategies against these new entrants. The incumbents must utilise innovative technologies and new forms of delivery, which are focused within the value chain, outsourced and integrated with up-to-date systems and infrastructures in order to remain competitive (Falkena *et al.*, 2004). In some countries new entrants into some banking sub-markets, especially in the retail banking have included supermarkets, motor car manufacturers, do-it-yourself furniture stores, the post office, utility companies, insurance companies, and even well known football clubs (Falkena *et al*, 2004). The internet has changed the meaning of distance and geographical significance of places in the business fraternity. Leinbach & Brunn, (2001:104-105) argue that the relative connectivity of cities on the internet- a band of networks, is bringing firms into proximal locations, as a result barriers to entry in the industry are difficult to establish with customers being reachable on commercial cyberspaces.

*Bargaining Power of Customers.* The extents to which customers wield power through purchasing strength clearly influence the competitiveness of a market. When a banking market is dominated by a few number of clients or where the client takes a large proportion of the bank's service, competition from customers is likely to be high (Malcolm & Martin, 2003:98). Additionally, competition intensifies in an industry when buyers threaten to integrate backwards (Hollensen, 2003:78). This has been prominent with traditional clients in the financial sector now involved in certain banking activities (Falkena *et al.*, 2004). Technological dispensation in communication and transportation has empowered customers (Kotler & Keller, 2006:13), and today's customers are highly informed and technologically enabled (Baker & Bass, 2003:1-2). The growth in mobile phone ownership has led to customers being a step-ahead of marketers. Baker and Bass (2003:1) describe the new customer as someone who is complex and somehow a difficult creature to serve. Customers have a wider choice of channels through which to connect with a brand and this is exacerbating the switching and mobility of customers, consequently the obvious result is increased customers' bargaining power. Banking is increasingly moving to online, thus, the resulting effect of technology in bank clients is even more established and more pronounced.

This same consumer has been exposed ceaselessly to empowering technological advancements consequently widening the customer's reach. The presence of the internet and mobile digital connectivity has eliminated the banking boundaries for clients. Customers have seized to be only the consumers of services and products. Out of the desire to obtain higher customer satisfaction levels, customers are collaborating with producers in the production of services/goods. More and more customers prefer different versions of the same product or service (Hollensen, 2003:398). Customisation favours modern technologies, and it is critical for firms to identify customer needs on an individual basis. The internet offers marketers the potential to view customers on a more personalised basis, and this enables customers to have products as per the order from across the globe. Through online services customers can co-create value through knowledge, interactions and experiences. Increasingly banks should be tailoring products at different rates for different clients and bringing new competitive offerings to the market (Strasheim & Pitt, 2001:38).

Internet enabled mobile devices are hurting and haemorrhaging specifically to banks which fail to adopt technology accordingly. Cellphone banking apart from internet banking, is currently the way of the future (Fisher-French, 2007:1), with a large number of South Africans owning cellphones plying the potential for further developing marketing opportunities. Customers increasingly require instant gratification enhanced through the use of new technologies. In the same limelight, (Gordon, 2007:19) argue that there is an increasing number of banking clients who view cellphone banking to be cheap, secure, efficient, and more than anything convenient. Generally, the ownership of home PCs is increasing and overwhelmingly the future of banking will be carried in-doors with clients being able to do banking twenty-four hours a day and seven days a week. What it means is that by ownership of modern technologies, customers will continue determining the pace of doing business, and who to trade with. The old adage 'a customer is king' has been increasingly fulfilled through the use of technology (Terbalanche, 2005:10; Weeks 2002:5). The affordability of high performance technology, ability to complete transactions faster and more conveniently as well as the abundance of market information and knowledge also empowers contemporary customers (Zineldin & Vasicheva, 2008:118).

**The Bargaining Power of Suppliers.** ***The bargaining power of suppliers tends to be intensified when suppliers are concentrated or they contribute the larger component of the products that are bought by the customer. They can bargain for higher prices and this reduces the profitability of the bank (Jain, 1997:91). All firms play the role of the supplier and customer in their competitive environments and each firm needs to balance its position as a customer as well as a supplier (Hellriegel*** **et al.*****, 2004:106). Malcolm & Martin (2003:98), also suggest that competition from suppliers is also increased when suppliers threaten to integrate forward. Fortunately, banks prominently operate in oligopolistic markets and as customers they command high bargaining power to their suppliers. However, with the banking***

***technologies (softwares and hardwares) being supplied by few manufacturers, positing a challenge to banks (Mia* et al, *2007:41). Conclusively, in electronic markets suppliers can be considered as neither high nor low (Aronsohn,* et al., *2006:13)***

## *Competitive Technological Marketing Strategies for firms*

Electronic marketing-the execution of delivering customer benefits and satisfaction coupled with electronic marketing resources is growing at a high tempo. Certainly, technology modifies several aspects in the context of marketing. In these contemporary technologically aggressive environments, competitive marketing strategies derivative of the effects of technology are obviously the answer to encapsulate the challenges of increasing competition. Deighton & Kornfeld, (2007:7) argues that with the massive advent of interactive technologies, contemporary marketing has seized to be a matter of domination and control rather a matter of fitting in. Marketers need to appreciate the power of advanced technologies because competitive advantage is increasingly dependant on the application of advanced technologies (Porter, 2001:66; Padgett & Mulvey, 2007:376; Kamel, 2005:308); developments in business related technologies enable the formation of international firms and a globalised consumer (Weeks, 2002:4); e-commerce has no geographic boundaries because the internet creates connectivity throughout the world (Ambrose & Fynes, 2006:3); technology influences action plans, as well as plans and goals (Lancaster & Reynolds, 2005:355). Advances in technology result in effective and efficient marketing process and outstandingly modern technologies have been able to provide better solutions contemporarily to marketers in areas such as the following:

Technologicalship Marketing

According to Sheth & Parvatiyah (2000:135), modern technology advances in IT, the current developments in sophisticated electronic and computerised communication systems make the maintenance of relationships easier. As suppliers and customers are dedicating their efforts towards massive technological application in business practises, the end result is that there is a possible disappearance of personal contact between the customer and the supplier. As a result marketers should endeavour to integrate technology and relationship marketing to create long-standing relationships. The concept of technological-ship marketing advocated for by Zineldin, (2000) is critical for successful relationship marketing programs. Marketers need to consider the development of proper technological-ship marketing programs in place of relationship marketing. Technology provides greater networking and communication capabilities which maintain and enhances contacts in relationship marketing. One of the major strategies of value creation in e-banking is the ability of websites to attract and maintain clients within the e-commerce zones (Hollensen, 2003:433). Lamb *et al.* (2002:649), argue that information contained in the websites helps banking managers to know and understand their customers on a one-to-one basis. They further argue that through websites banks obtain the opportunity to build close relationships with customers, and they can tailor banking products according to client specifications. Computerised systems should be designed from a customer perspective and not only from internal productions and productivity-oriented viewpoints

***Technology-led market segmentation***

E-commerce brings a fresh, creative and rewarding interpretation of market segmentation and the establishment of a solid and sustainable competitive position in a market. An active and participative marketing mix can be created for a particular target market through the application of technology. For instance a bank which has an effective and functional website can effectively and efficiently promote its offering by streamlining its services to individual customers (Reedy & Schullo, 2004:147). Furthermore, marketers can attain the target market through the use of geo-demographic software models which offer reports, mapping and analysis of customers in a particular market. Customised marketing is being used by many firms to improve customer service experience. Banks, for instance use caller identification software to sort through in-coming calls. A certain customer is served by a specific operations group. Technology affects customer services by providing specific capabilities to the marketing function; these are speed and accuracy through which sophisticated technologies perform certain tasks (Eccles *et al.*, 2000:39). Technological advances enable the marketer to identify specific prospects and deliver specific products/services for consumption by specific target markets.

***E-promotional mix marketing***

Marketers are demanding more and more performance from their promotional expenditures (Reedy & Schullo, 2004:182), and they have greater value expectations for research and development expenditures. Technology influences almost every aspect of a marketing strategy. Most strategies have four elements which are; goals, strategies, action plans and programs (Ettlie, 2000:93). The strength of the Web integrates and enhances the elements of the promotional mix. Technology enables marketers to design and manipulate promotional mix elements to maximise promotional benefits in different stages of the product life-cycle. For instance, in the declining stage of the product cycle personal selling complements promotions in pushing sales of the product as long as possible (Reedy & Schullo, 2004:221-255). In technical terms, technology provides promotional interactiveness. While in conventional terms, with the development of client/ server applications, commercial messages easily flow between the supplier and the client. This gives the supplier a transmission capability. Today, more and more people own digital communication devices, which provide the potential and capacity of enhancing numbers of business activities.

***Technology-driven marketing research***

Research has greatly benefited from the developed technologies. Amongst modern sophisticated technologies the internet and database have widely improved information gathering. Precisely these two result in faster and ease desktop research. One of the best marketing research tool is examining the competitor's web page, therein management can obtain a variety of valuable information on competitor's offering (Reedy & Schullo, 2004:244). Since the web is used by many firms as the medium of communication with customers and other stakeholders. Also it is the doorway to online shopping for customers, as customers can click on hyperlinked tabs to get to different product categories. New technology increasingly facilitates the ease with which vital information for effective planning and decision-making can be collected, analysed and used. Advances in technology result in effective and efficient marketing process.

***Technology in marketing controls***

E-commerce aggravated trepidation amongst would-be customers and suppliers of many online sites (Reedy & Schullo, 2004:366). Certain technologies today can perform certain control functions for marketing. To achieve the goals for marketing, the basic marketing philosophy of identifying and satisfying customer needs, certain marketing information is necessary. Comprehensive, reliable and up-to-date information is required by marketing from within and outside the organisation. Such information is needed for sales forecasts, and this include customer reports, market research studies, market analyses, competitors, and economic trends (Eccles *et al.*, 2000:516-517). Equally important this information is essential for checking customers' creditworthiness, which also forms part to marketing controls especially were credit transactions are involved.

***Technology in distribution channels***

In the financial sector technology is increasingly substituting traditional distribution channels. E-banking in form of cellphone banking and internet and ATMs is replacing the brick and mortar banking. The decrease in costs of getting to the internet and owning PC's increases prospects of technology taking over traditional distribution channels in the financial sector (Chen, 2001:26).The adoption of technology for the web lifestyle is happening faster than was the care with electricity, cars, TV's and radios. The use of PCs has exploded in the workplace, homes, and schools. As consumers more readily accept and use the internet, more financial transactions (including banking, mortgage, utilities, and use of credit cards) will occur online. Computer software already enables clients to calculate online the effect of various instalments on their bank accounts while payment of bills is conveniently done online (Gates, 1999:131-134). Firms should be aware that the impact of technology goes further than just using it for e-commerce but also to develop competitive strategies to gain competitive advantage and by providing useful information, expanding choice, developing new services, streamlining purchasing processes and lowering costs (Hollensen, 2003:401).

Technological upheaval and connectivity will transform competition and make product differentiation difficult. Banks have to consider consolidating their distributed database systems and integrate all their delivery channels with a view of delivering better services to their customers. South African banks experience an increase in the use of ATMs, Cellphone banking, and Internet banking as additional delivery channels. By combining e-data and traditional customer data, banks can personalise cross-selling campaigns and deliver them via the most appropriate channel Understanding the marketplace and responding to its demand require up-to-date technological linkages. Sophisticated computer technology link marketing to the different business departments or other functional areas, such as information technology, finance, research and development, and customer service. All these functional areas are sustained by the same marketing information. With the internet and intranet greatly impacting the interaction of the whole enterprise, the IT department has largely become involved in the marketing strategies of the firm as they are tasked with developing the firm's website, a major marketing communication tool (Lamb *et al.*, 2002:637-638).

# METHODOLOGY

A sample of 90 respondents was utilised in the primary research surveys. These respondents were selected using convenience sampling. The research was carried out in King-Williams Town in the Eastern Cape province of South Africa and it was directed at the Standard Bank branch located in this area. The target population of this study was the customers, and to the scale of this study, as in many cases, the actual population figure could not be obtained since it is usually difficult to specify the actual number of the population and specify the elements (Cant *et al.*, 2005:178). Of the 90 respondents, the study also investigated 10 employees of Standard Bank to further obtain more substantive data about the customers from the employees' perspective. The research used self-administered questionnaires and personal interviews in the form of intercepts in the collection of data. The questions contained in the questionnaire were mainly dichotomous questions, likert scale and checklist questions with a few open ended questions. These interviews were conducted in a structured form, and they were conducted with employees and customers at designated points on the Standard Bank banking site and ATMs in the area of study. The data collection was administered during the month of October 2007.

# DATA ANALYSIS AND RESULTS

STATISTICA is the statistical package which was mainly used in this study. The packages, Microsoft Excel and SPSS were also used for the analysis and production of graphs and tables. The research primarily uses descriptive statistical methods with the chi-square being the only inferential statistic which was used in this study. The chi-square method was utilised to establish the significance of the results amongst the variables tested by the study and it was also used to test for association of variables. Exhibit 1(table 1) below highlights on the p-values obtained after carrying the tests of associations. The significance outcomes for testing of associations from the items measured by research instrument conclusively evidence a reasonable and concrete ground to accept that the questionnaire was a reliable measure of the objectives and test of hypotheses of the study. Much of variables tested by the questionnaire had significant relationships. Reliability was established through the pre-testing of the two sets of the questionnaires amongst ten customers and five employees respectively.

**Table 1: P-Values Relating To The Major Variables**

| VARIABLES | P-value |
|---|---|
| Technology use and ranking of Standard Bank | 0.0350 |
| Technology use and customer partnership | 0.0144 |
| Technology use and user-friendliness of banking methods | 0.0101 |
| ATM usage and user-friendliness | 0.0305 |
| Gender and ownership of computers | 0.0003 |
| Computer banking by income group | 0.0004 |
| Computer banking by education | 0.0386 |

The study principally hypothesised that the use of modern banking technology significantly impacted service delivery to clients by Standard Bank in King-Williams Town. To ascertain the conclusions to this hypothesis, the obtained data was analysed based on the objectives of this study which are outlined below.

***Primary objective***
To determine to what extent Standard Bank in King-Williams Town implemented advanced banking technologies in marketing strategies and practices.
Secondary objectives

- ✓ To determine the extent to which Standard Bank's marketing strategies employed technology in gaining a competitive advantage.
- ✓ To determine the clients' perceptions on the level of satisfaction gained through the use of technology in transacting with the bank.
- ✓ To ascertain to what extent customers utilised the various modern technologies of transacting with Standard Bank in King-Williams Town.

- ✓ To outline technological characteristics that could be improved by Standard Bank in King-Williams Town in service delivery.

*Technology utilisation in service delivery and competitive advantage*

The responses of customers were statistically weighted in order to attain a ranking criterion. While on average the results show that Standard Bank leads the market in technological adaptation, the results reveal that the bank's customers perceived it as second to ABSA in using modern and sophisticated technologies in marketing. This is reflected by the findings from the study where 41% of the participants ranked ABSA first, while 38 % ranked Standard Bank. Both banks using the mode occupied the 1st rank as the leaders in technological utilisation with FNB occupying the 3rd rank and there was no bank ranked 2nd. Altogether 82.5% of the customers responded that they were influenced to bank with a bank which uses advanced modern banking technologies; with the remainder of the respondents indicating that their choice is not influenced by the bank's level of adoption of sophisticated technologies. It is highlighted that 100% of the employees agreed that Standard Bank regards the use of advanced technologies as a competitive marketing tool.

*Client's satisfaction gained from using advanced technology*

The researchers mainly used loyalty constructs to measure the satisfaction of customers and to determine the extent to which customers were attached and loyal to the technological facilities of Standard Bank. It is envisaged that satisfied customers are retained customers; consequently, satisfaction is strongly correlated to long-term relationships (Fang Wang, 2004:19). Altogether 71% of the customers interviewed noted Standard Bank's technological facilities as user-friendly. 90% of the customers responded that they would encourage others to bank with Standard Bank and the remainder said they would not encourage friends or relatives. This reflects high customer loyalty.

*Utilisation of advanced banking technologies by customers*

The researchers required customers to rank their preferences of the banking methods. The results were analysed as weighted averages and the weights are as follows: 1 =5 points, 2 =4 points, and 3 =3points, 4 =2points, 5 =1point. The information shows that on average most customers prefer banking through ATMs followed by cellphones, and the least preferred method is telephone banking. Consistently, the majority of the employees on average perceived that customers were heavily using ATMs and over the counter banking methods. On average 39% respondents have been using the noted recently developed banking methods. In the presence of a multi-channel distribution system in the banking sector, this percentage reflects a significant representation. A sound basis to make conclusions on the significance of modern banking technology is also cited by the results on banking methods preferences by customers, where on average customers gave 41% rating over the recently developed banking methods. Conclusively, the majority of the clients perceived the use of sophisticated banking facilities by banks as a means of transacting and as an essential aspect in service delivery.

*Suggestions and areas of improvements*

The final questions of both questionnaires required the respondents to make suggestions to the management in order to improve the use of technology in service delivery. Most respondents were reluctant to answer this question. In most cases it was left unanswered and those who attempted it, the majority of the answers were not comprehensive. However, the main suggestions from respondents are outlined below from the most said to the least said:

- ✓ Standard Bank should implement awareness programs to customers on how to use the modern advanced banking technologies;
- ✓ The effects of the advanced banking methods should be more visible to customers in form of lower service charges;
- ✓ The bank should train their employees to be more effective and eliminate problems at banking points;
- ✓ The bank should focus at improving security especially to eliminate threats at ATMs and internet banking;
- ✓ Standard Bank should increase the distribution of ATMs and make them more universally accessible to customers;
- ✓ Improve and promote cellphone banking through communication mediums such as TVs, radios, and the internet;
- ✓ The bank should attempt to use more simple and accessible banking methods while also reducing functionality problems of ATMs; and
- ✓ Expand point-of-sale to small shops.

## CONCLUSIONS AND DISCUSSION

Fierce competition and unexpected technological shifts make price manipulation and promotional tactics costly and unproductive. With electronic marketing resources, marketers can be forewarned on unproductive and costly competitive strategies through the utilisation of unique technologically added values (Reedy & Schullo, 2004:6). The need for efficiency and reliability has contributed to the automation of many basic operations, giving businesses reflexes to efficiently manage basic day to day elements, such as customers, products or services, revenues, costs, competitors, deliveries and employees (Gates, 1999:25). As consumers get more empowered, current technologies adequately facilitate the comparison and alignment of firms and their products. The computer-mediated environment has profound implications particularly in the banking sector. In the last decade, there has been a proliferation of access options allowing individual consumers to self-define banking convenience (Wai Ching, 2008:59). Success in many industries does not depend on a competitive infrastructure of buildings and machinery, but on a computer and digital communications platform which are necessary in the competition game (Hollensen, 2003:395). The development of automated buying profiles, networked buying clubs, and online auction will exacerbate competition.

The internet has critically affected customers need satisfaction; electronically fulfilling customer requests efficiently can strategically improve customer satisfaction. More so, responding to customers quickly brings positive results to marketing. Technology has not only changed the way marketers market their products, through the interaction between consumers and firms, but has also exacerbated the challenges posed by cross-functional co-ordination. However, firms are able to tailor products, services, and communications to meet customers on a one-to-one basis (Customer Relationship Marketing). Through database technologies, it is possible to have individualised marketing which anticipates long-term, personalised and profitable relationships (Lamb *et al.*, 2002:637-638). There is an overall move towards greater Internet access across the African continent. Data from Internet World Stats (www.internetworldstats.com) indicates that there were almost 13 million Africans online as of February 2005, representing an increase of 186.6% since 2000. Alarmingly, only 4% of internet banking customers is concerned about the security of their transactions (Kotze, 2005).

The current marketing environments require the formulation of strategies which curtails and synthesises the reinforcement of all the possible modern technologies available to the firm. The findings of this research also indicated that the majority of Standard Bank customers owned cellphones. The findings represented such an opportunity in cellphones and slightly in computers. The next subsection analyses the extent of utilisation of these methods. However, recent banking methods such as cellphone banking and internet banking reflected very low levels of usage by customers. An overview of ownership and use of online banking resources entails that there is no effective utilisation of technologies owned by customers. Further, banking methods preferences of customers substantiates that the majority of customers prefer modern banking methods to traditional banking methods. To a greater extent this information reiterates the fact that Standard Bank is successful in technological competitive marketing. However, technological marketing is not reaching up to the clients' expectation particularly mobile and internet banking. These results therefore are consistent with empirical results of the Mobility 2007 survey results. Findings of the Mobility 2007 survey indicated that of the 32 million cell phones in use in South Africa, 85% of the owners have bank accounts and only 17% have used mobile banking (Gordon, 2007:19).

## REFERENCES

Abratt, R. & Russell, J. (1999), Relationship Marketing in Private Banking in South Africa, *International Journal of Bank Marketing* 17(1) pp.5-19.

Aronsohn, M. Charif, H. & Charif, L. (2006), E-Banking and Service Qualtiy Online, (*Unpublished Masters Thesis*) Lunds Universitet. Helsingborg, Sweden.

Baker, S. & Bass, M. (2003), New Consumer Marketing, John Wiley & Sons Ltd, West Sussex, England.

Boone, L.E. & Kurtz, D.L. (1992), Contemporary Marketing, Harcourt Brace Jovanovich Publishers, New York, USA.

Cant, M., Gerber-Nel, C., Nel, D., & Kotze, T. (2005), Marketing Research, New Africa Books (Pty) Ltd, Cleremont, South Africa.

Chen, S. (2001), Strategic Management of E-Business, John Wiley & Sons, Inc., Chichester, England.

de Klerk, S. & Kroon, J. (2005), E-commerce adoption in South African businesses, *South African Journal of Business Management* 36 (1), pp.33-40.

Deighton, J.A & Kornfeld, L. (2007), Digital Interactivity: Unanticipated Consequences for Markets, Marketing and Consumers, *Harvard Business School Working Paper,* No. 08-017, September 2007.
Durkin, M.G. & Howcroft, B. (2003), Relationship Marketing in the Banking Sector: The Impact of New Technologies, *The Journal of Marketing Intelligence and Planning,* 21(1), pp.61-71.
Eccles, M.G., Julyan, F.W., Boot, G., & Van Belle, J.P. (2000), The Principles of Business Computing, Juta & Co. Ltd, Landsdowne, South Africa.
Ettlie, J.E. (2000), Managing Technological Innovation, John Wiley & Sons Inc., New York, USA.
Falkena, H., Davel, G., Hawkins, P., Llewellyn, D., Luus, C., Masilela, E., Parr, G., Peanaar, J., & Shaw, H. (2004) Competition in South African Banking, *Task Group Report for the National Treasury and the South African Reserve Bank.* [On-line]. Available: http://www.usaid.gov/sa/usaidsa/competitionbanking2004pdf
Fang Wang, B.E. (2004), Electronic Retailing: An Analysis of Web Impacts and Relationship Marketing Opportunities, *Ph.D. Thesis (Published)*, McMaster University-Canada Library and Archives, Ottawa, Canada.
Fisher-French, M. (2007), The New Battle for Your Buck, *Mail & Guardian* [On-line] Available: http://www.mg.co.za/personalfinance/articlePage.aspx?articleid=303167
Gates, B. 1999. *Business @ the speed of thought.* England, Harmondsworth: Penguin book Ltd.
Gordon, G. (2007), Markets Ready to Go Mobile. *Sunday Times,* November 25, South Africa
Grewal, R., Corner, J.M. & Mehta, R. (2001), An Investigation into the Antecedents of Organisational Participation in Business-to-Business Electronic Markets*. Journal of Marketing,* 65(3), pp.17-33.
Hellriegel, D., Jackson, S.E., Slocum, J., Staude, G., Amos, T., Klopper, K.B., Louw, L., & Oosthuizen, T. (2004), Management-South African Edition*,* Oxford University Press, Cape Town, South Africa.
Hollensen, S. (2003), Marketing Management-A Relationship Approach, Pearson Education Ltd, Essex, England.
Kamel, S. (2005), The Use of Information Technology to Transform the Banking Sector in Developing Nations, *Information Technology for Development,* 11(4), pp.305-312.
Kotler, P. & Keller, K.L. (2006), Marketing Management, Pearson Education, Inc., New Jersey, USA.
Kotze, C. (2005)*,* E-Solutions*, FNB News,* [Online]. Available https://www.fnb.co.za/news/archive/2005
Lamb, W.C. (Jr), Hair, J.F. (Jr), & Mcdaniel, C. (2002), Marketing, South-Western Publishers, Ohio, USA.
Lancaster, G. & Reynolds, P. (2005), Management of Marketing*,* Elsevier Butterworth-Heinemann, Amsterdam, Netherlands.
Leinbach, T.R. & Brunn, S.D. (2001), Worlds of E-Commerce: Economical, Geographical and Social Dimensions, John Wiley & Sons, New York, USA.
Malcolm, M. & Martin, C. (2003), Marketing: A Complete Guide, Palgrave Macmillan Ltd, New York, USA.
Mia, A.H., Rahman, M.A. & Uddin, M. (2007), E-Banking: Evolution, Status and Prospects, *Cost and Management*, 35, (1) pp.36-48.
Padgett, D. & Mulvey, M.S. (2007), Differentiation via Technology: Strategic Positioning of Services Following the Introduction of Disruptive Technology, *Journal of Retail Marketing*, 83,(4) pp.375-391.
Porter, M.E. (2001), Strategy and the Internet*, Harvard Business Review*, 7 (3), pp. 63-78.
Reedy, J. & Schullo, S. (2004), Electronic Marketing-Integrating Electronic*.* South Western Publishers, Australia.
Sheth, J.N. & Parvatiyah, A. (2000). Handbook of Relationship Marketing, Sage Publications Ltd, London, UK.
Stevens, R., Loudon, D., Wrenn, B., & Mansfield, P. (2006), Marketing Planning Guide, Haworth Press Inc., Binghamton, USA.
Strasheim, A. & Pitt, L. (2001), *Home-Made Scones on the Internet,* Management Today Yearbook, Curtin University of Technology, Australia.
Terblanche, N.S. (2005), A Century of Marketing: Achievements, Mishaps and Future Challenges*, Management Dynamics*, 14, (4) pp.1-17.
Wai-Ching, P. (2008), User's Adoption of E-Banking Services: The Malaysian Perspective, *Journal of Business & Industrial Marketing,* 23 (1), pp 59-69.
Walker, O.C. (Jnr), Mullins, J.W., Boyd, H.W. (Jnr), & Larrèchè, J. (2006), Marketing Strategy–A Decision-Focused Approach, McGraw Hill, New York, USA.
Weeks, R.V. (2002), Key Determinants in Strategic Realignment within a Digital Global Business Environment*. PHD Thesis (Unpublished),* University of Johannesburg. Johannesburg, South Africa.
Zineldin, M. & Vasicheva, V. (2008), Cybernization Management in the Cyber World: A New Management Perspective, *Problems and Perspectives in Management,* 6 (1), pp.113-126.
Zineldin, M. (2000), Beyond Relationship Marketing: Technologicalship Marketing, *Journal of Marketing Intelligence and Planning*, 18(1), pp.9-23.

# BRAND MARKING WORKS IN PRIVATE HOSPITALS

**Selma Söyük**
**Istanbul Universty, Turkey**
**Onur Yarar**
**Okan Universty, Turkey**
**Melih Erol**
**Bakırkoy Doctor Sadi Konuk Education (Training) And Search Hospital, Turkey.**

## ABSTRACT

*Although brand marking has fully developed in the other sectors, it has been developing in the health area. It became a sector in the 1990s. Although it has been newly started, it must be as quick as possible , because increasing competition and marketing conditions make the hospitals work hard in brand marketing and institutionalisation. Brand managing has become one of the most important parts of the competition, because nowadays , individuals have different kinds of brand choices. In this study we have tried to put forward the brand marking position of the hospitals in 2008. After the work, the brand marking rate is found as 3.96. We can say that this result is good for the private hospitals.*

***Keywords:*** *Hospital, brand, brand marking and health services*

## INTRODUCTION

Brand ,which affects the consumer's and his /her shopping decision period and that gives shape to it and also that distributes the concrete goods, is the common point of marketing and advertising actions. Branding is very important for the business enterprise. Finding new costumers and committing them to the firm, costs five times more than keeping the old customers. Therefore the organisation tries hard to keep the old customers and not to lose them. At present, hard competing conditions, the changing features of the customers makes the producers own and design strong brands. Originally, hospitals which have been the oldest organizations since the beginning are among the organisations that quickly follow the technology and the changes. The number of hospitals increase day by day and therefore in order to serve better and to keep the patients , they must be a good brand. It is thought that efforts in branding have been very important in hospitals in the last years.

## BRAND MARKING CONCEPT

Today, from economy to art, from science to politics there is a globalisation period that affects everything in the world. The world market is globalising so quickly that the information technology which restructures the values and choices of the customers and the brands which become larger make the relations between the customers and the brands more complex. The brand is a link between the customer and the goods. Therefore, brand marking management has become the most important part of competition in the world, because the individuals have many different kinds of brand choices. The brand affects and shapes the customers' desion period. The brand separates the goods from each other. Brand marking is the main point of Marketing and advertisement activities. The brand is not only the logo and name but it also implies the feelings ideas of the customers about the institution and the products(Prasanna 2008). Many managers think that brand marking is an action of some marketings and sales in order to form a brand identity (Chernanotony, Riley 1998).

## The Methodology and Result of the Research

In the research, branding measurement was used which was developed by the researchers .Factor analysis of the measurement was done. Cronbach alpha results were examined. In 2008, n=137 questionnaires ware sent to all of the private hospitals in Istanbul and one of the executive managers was asked to answer it. E-mails were sent to some of the intuitions and face-to face meetings were done in some. As a results %54 of the questionnaries were turned back fully. The turning back rate of the questionnaires were %39.The questionnaire was in two parts. In the first part, questions about the socio-demographic features of the managers in the organizational structures were asked . In the second part branding was asked. In the literature study, it was seen that the Works about branding were very few in the health sector in Turkey and it wasn't enough, Therefore, to see the branding positions and the level of the private hospitals, this survey was done. The work is descriptive.

Brand marking measurement: In order to measure the brand marking level of the hospitals, the researchers looked through the literatures and they used a 5 Likert type measurement which had 13 questions. They also used a form with 17 answers and they had only yes or no answers.

They had the validity and reliability of the brand marking measurement .It had two factors and the measurement could be used as a single measurement. The brand marking and its factors Cronbach alpha coefficients were like these:
Factor 1 (0.96),
Factor 2 (0.94),
General measurement (0.96).

Factor 1 had 8 articles (6.,7.,8.,9.,10.,11.,12.,13. articles), factor 2 had 5 (1.,2.,3.,4.,5.,6.,7.,8.articles)
In order to search the validity of the measurement and to determine the factors, facor analysis was used. In order to search the reliability of it t test and material-total point correlation were used and also to see the reliability of the measurement reliability analysis is used

When we look at the results we can see that half of the participants are female (n=26) , half are male (n=28) managers. When their education level is examined % 29.6 of them are college graduates, The grad school graduates are % 44.4 . %24.1(n=13) of the managers are "General coordinators", %20.4 (n=11)are managers working under an agreement /or marketing managers %31.5'i (n=17) . %83.3'ü (n=45) of the hospitals have taken name patents . %13'ü (n=13) haven't taken yet.%22.2of the hospitals have no mottos.

As it is known, in brand marking, one of the most important factor is the mission and vision identification . And every worker must know this mission and vision.

**Table 1: The Frequency of Hospitals Having a Written Mission**

| | *Frequency* | *Percentage* |
|---|---|---|
| Has written mission | 46 | 85.2 |
| Has no written mission | 8 | 14.8 |
| Total | 54 | 100 |

%85.2 (n=46) of the hospitals have a written vision , %14.8 (n=8) have no vision

**Table 2: The Frequncy of Hospitals Having a Written Vision**

| | *Frequency* | *Percentage* |
|---|---|---|
| Has written vision | 46 | 85.2 |
| Has no written vision | 8 | 14.8 |
| Total | 54 | 100 |

Especially in institutional work , besides having a written mission, having a written vision is also very important. And you must have them.

Questions about having brand marking activities in their areas were asked to the managers. We aimed to see the brand marking activities in the hospitals. %64.8(n=35) of them answered that there were brand marking activities in the hospitals , %33.3 of them said there weren't any. Brand marking has positive affects on the competitiveness in the private hospitals and therefore you can't ignore or give it up. The units which are responsible of the brand marking activities in the hospitals are shown in Table 3. The marketing unit is more responsible than the other units (% 24.1, n=13) and Human Relationship unit is also responsible (%16.7, n=9). As it is explained in the second part this is applied in many sectors like this.

**Table 3:The Frequency of Units Which are Responsible of Brand Marking Activities.**

| | *Frequency* | *Percentage* |
|---|---|---|
| Head doctor | 4 | 7.4 |
| Marketing | 13 | 24.1 |
| Human relationship | 9 | 16.7 |
| Human resources | 2 | 3.7 |
| Others | 10 | 18.5 |
| No answer | 16 | 29.6 |
| Total | 54 | 100 |

## The Factor Analysis of Brand Measurement

The aim is to investigate the data's in the measurement and to see whether they are suitable for the factor analysis or not. In the validity work of the brand marking measurement by applying measurement instrument, the collected data's being suitable to the group is at level 0.001 KMO value is 0.90. Barlett Test meaningful value is 816,962 (p=0,000) As a result we can say that the two measurements are suitable for the data's' factor analysis.

The common variations of the variables in the measurement have been examined and is shown in Table 4. Communality (common variation)is the amount of variation that shares with the other variations in the analysis of the variation .In factor analysis the variations that have lower common variations (for example below 0,50)can be taken out and factor analysis can be tried once again. In this situation both KMO and explained variation value statistics' value will be higher. If the communalitinin value is above 1 it means that the data set is either too small or too many or a few factors have been mentioned in the research.

**Table 4: Commun Variation Table Brand Marking Measurement (Communalities)**

| No | Initial | Extraction |
|---|---|---|
| M1 | 1,000 | ,620 |
| M2 | 1,000 | ,880 |
| M3 | 1,000 | ,849 |
| M4 | 1,000 | ,819 |
| M5 | 1,000 | ,914 |
| M6 | 1,000 | ,777 |
| M7 | 1,000 | ,910 |
| M8 | 1,000 | ,788 |
| M9 | 1,000 | ,813 |
| M10 | 1,000 | ,749 |
| M11 | 1,000 | ,846 |
| M12 | 1,000 | ,774 |
| M13 | 1,000 | ,722 |

Determining the values of the charges and the factors in which materials take place.
n brand marking measurement factor, ( when rotated component matrix is examined in Table 5) you can see that 2 factors are formed and brand marking measurement 7, 11, 9, 8, 10, 6, 12, 13`are the first .factors (introduction and the results)element 2, 5, 3, 4 and 1are under 2 factors (name of the brand) gives the highest values. Although the first element seems not to be connected with the related factors, the elements in the factors in which they belog to have great values . Therefore they have been taken into the factors.

**Table 5: The Relationships between the Brand Marking Sub Factors and Total Measurement Point**

| | Factor 1 | Factor 2 | Total |
|---|---|---|---|
| Factor 1 | 1 | 0.772 | 0.918 |
| Factor 2 | | 1 | 0.961 |
| Total | | | 1 |

P<0.001

As can be seen in table 5 sub factors have positive and meaningfull correlations between themselves and total measures. These findings are considered to be the proofs for the measurements being structural validity.
The used brand marking scale's Cronbach alpha coefficients are given in table 6.

**Table 6: Cronbach Alpha Coefficient of Brand Marking Scale**

| | *Number of the elements* | *Cronbach alpha coefficient* |
|---|---|---|
| Brand Marking Scale | 13 | 0.96 |

**Table7: Cronbach Alpha Coefficients of Brand Marking Scale**

| | *Number of the elements* | *Cronbach alpha coefficient* |
|---|---|---|
| Factor 1 | 8 | 0.96 |
| Factor 2 | 5 | 0.94 |
| Brand Marking Measurement | 13 | 0.96 |

Finally when we examined the brand marking position of the hospitals we found it as 3.96 . It means that the hospitals are in rather good positions.

**Table 8: The Average of Brand Marking Scale**

| | Average | Standard deviation |
|---|---|---|
| Brand marking scale | 3,960111 | ,8789371 |

# THE ARGUMENT AND RESULT

Aaker (2001) explained the ways how to make brand capital . He also emphasized that the firms which have brand value have more competition force .According to Aaker, the position of brands pushes the firm among the leading firms. Aron ve Debra (2003) the value of brand added to the product and the cost of consumers' good search decreased the level of the risks perceived and the quality of the good was decided. This understanding of the real brand will be for the benefit of the consumer, Focusing on functional and sensational subjects, it has the important factors that support the legal base. Uncles (1997), proved that the branded companies' marketing expenses were decreased and for the customers it became easier to recognize to the institution could imply itself easily. Davis (2002), As a result of the research which was done among the consumers, it was seen that % 50 of the consumers continued buying the new products of the strong brands without asking any questions. Also %72 of the customers were eager to pay %20 more to the close brand. Chernatony(1998), proved that the brand makes the good to be in the market and it also makes the price of the goods and it helps the product to increase its share in the market. After a long study Keller(1993), proved that the good branded intuitions had symbols The most important and the first point of the symbol design is that the symbols remind you the brand.

If we look at the results of the work; most of the managers of the hospitals are either university graduated or post graduated. And most of them have been working there for one or five years. If the organizations want to be successful, they must try to find the ways how to keep the hardworking, qualified and talented workers for a long time. Also, if the organization wants to be successful in branding and others, they must conceive that the top managers should be educated about management. One of the most important points in branding is deciding a motto(slogan) and using this motto all the time.%25 percent of the private hospitals who joined our work have no mottos . Name patents have been borrowed. %83 The branding works have been managed by the marketing department .(%24)In our work ,which we decided to measure the branding levels of the private hospitals , it was seen that the branding level of the hospitals was only 3.9/5,(The evaluation point is 5) We can say that from this point of view the hospitals are in good level and and are developing quickly.

## REFERENCES


Aaker,D., (2001), Managing Brand Equity: Capitalizing On The Value Of Brand Name, Free Pres, New York.

Anberg A.,(2000), What You Should Know About Branding And Brand Value, , Mc Grow Inc., New York.

Andrew, W., (1993), The Institutional Theory of Jonn R. Commons, *The Academy of Management Review,* Vol. 18, p. 121-125.

Arnold D., (1992), The Handbook Of Brand Management, The Economist Books Ltd., London, .

Beverland, M.,/2005), Brand Management And The Challenge Of Authenticity", *Journal Of Products & Brand Management*, Vol. 14, No: 7, p. 460-461.

Boyle E., (2007), A Process Model Of Brand Cocreation: Brand Management And Resarch Implications, *Journal Of Products & Brand Management*, Vol. 16, No: 2, p. 122- 131.

Chernatony, L., (1998), Defining A Brand: Beyond The Literature With Experts Interpretations" *Journal of Marketing Managemen*t, Vol: 17, No:7-8, p. 417-443.

Chernatony L., Riley F.,(1998), "Defining A Brand: Beyond The Literature With Experts Interpretations" *Journal of Marketing Management*, Vol: 17, No: 7-8,p. 418-424.

Davis S., (2002), Brand Asset Management: Driving Profitable Growth Through Your Brands, Jossey-Bass, 2'nd Ed.

Fache D., (2001), A Core Strategy-Developing A Branding, *Health Forum Journal*, January-February, p.36-50.

Keller K., (1993), Building, Measuring, Managing Brand Equity, Upper Saddle River, Prentice Hall, New Jersey.

Knoks S.(1997), The Death Of Brand Deference: Can Brand Management Stop The Rot?, Journal Of Product & Brandg Management, Vol. 6, No: 1, p. 49-55.

Logman M. (2007), Logical Brand Management in a Dynamic Context Of Growth And Innovation, *Journal Of Product & Brand Management*, Vol. 16, No: 4, p. 257-268.

Raj P., Choudhary A., (2008), Conceptual Framework on Corporate Branding, *The Icfai Journal of Brand Management*, Vol. V, No: 1, p.10-.21.

Wood L., Brands and Equity: Definition and Management, *Management Decision*, Vol:38, No:9, p.662-669.

# INTERNATIONAL MARKET SEGMENTATION PARADOX FOR STRATEGIC MANAGEMENT: PURELY LOGICAL OR HIGHLY INTUITIVE

**Melis Attar-Emine Öğüt**
**Selçuk University**

**Metin Kaplan**
**Nevşehir University**

## ABSTRACT

*International market segmentation is a mature concept in strategic management theory and practice. It is the means to develop a sustainable competitive advantage by identifying customer groups across national borders having homogeneous needs and by offering a different marketing mix that appeal to one or more of these groups. The main object of this paper is to question whether there is a proper way to segment markets by focusing on the idea that managerial intuition and experience that gives credit to dynamic segmentation shall be recognized in segmentation process instead of approaching in a purely logical manner. It is concluded that segmentation process has a dynamic, unclear and intuitive nature. Several opportunities for further research arise.*

*Keywords: International Market Segmentation, Global Marketing Strategies, Dynamic Segmentation, Managerial Intuition*

## INTRODUCTION

Going international has proven to be one of the primary ways for growing a business to gain competitive advantage. Unfortunately, the complexities of globalization are so challenging that even some of the largest and powerful companies struggle to survive from the global competition. Those that are most successful to survive recognize that there is no one global consumer with one global product. Targeting pure and true globalization is an illusion that ignores the linkage between the issues of homogeneity and heterogeneity (Adcock, 2000: 65). In modern markets, some companies like Microsoft may well be considered more global than the others due to their technological advances, however, even the ones that have created a global taste like Coca-Cola and McDonald's, seek to meet the specific needs of the diverse market place with some adjustments in their products (Adcock, 2000: 65). Thus, there is no purely global product instead there is a "glocal" one realizing in-dept the local needs with global concepts and technologies (Mesdag, 2000: 74; Maynard and Tian, 2004). In the light of this new form of globalization – glocalization and its effects on global competition, the issue of *where* to compete shall be discussed since reaching the right customer with the right marketing mix has strategic importance for companies that are going global in their strategic management decisions.

When Theodore Levitt (1960; 1968) has argued about the emergence of global marketing strategies for global customers, his standardization approach is criticized by many scholars as being far from real practice (Baalbaki and Malhotra, 1993: 19). Instead, according to Baalbaki and Malhotra (1993), despite the advantages of complete standardization in terms of its economies of scale, variation in consumer needs and preferences should be taken into account while making strategic management decisions to play in international scenes. For instance, Coca-Cola recognizing the international demand heterogeneity has launched New Coke, Cherry Coke, No Caffeine Coke, No Caffeine Diet Coke (Dickson and Ginter, 1987: 1), Coke Zero, Coke with Vanillin and Coke with Lemon in addition to Classic Coke, Diet Coke. Each of them serves to different tastes and this strategy has increased the market share of Coca-Cola highlighting the success of a segmentation strategy (Dickson and Ginter, 1987: 1). Baalbaki and Malhotra (1993) further suggest:

*"Although global markets exist, a firm, in order to survive global competition, needs to target its products at 'specific segments' across different countries." (Baalbaki and Malhotra, 1993: 19)*

In the light of the argument that international market segmentation, by offering both the advantages of standardization and customization, as a strategy is the inevitable result of 'glocalization', this study questions the dilemma which is about how to find the best way to segment markets. It is suggested that during the segmentation process, managerial intuition and experience that gives credit to dynamic segmentation shall also be recognized instead of approaching in a purely logical manner. By looking from a more critical perspective, the whole notion of international market segmentation suffers from ambiguity. Although its significance for firms in surviving from intense competition is clear, the dynamic, unclear and intuitive nature of it problematize the appropriate choice of international market segmentation strategies and their implementation.

*This study has a descriptive feature in the sense that it is based on intellectual elaboration of international academic articles within a theoretical framework. Intent is to offer a roadmap for future research by analyzing and linking the relevant literature.*

## INTERNATIONAL MARKET SEGMENTATION

International market segmentation is the means to develop a sustainable competitive advantage by identifying the customer groups across national borders having homogeneous needs and by offering a different marketing mix that appeal to one or more of these groups. In a strategic context, it assists the companies in targeting potential customers and positioning their products effectively (Craft, 2004). In international markets, by targeting a specific group, the precise needs will be better matched by a modified offering (Adcock, 2000: 106). It is almost impossible for a company to grasp all the heterogeneity in the market at the same time and with identical marketing strategies. Trying to do so will lead to insufficient realization of customer needs and wants. As an alternative, a company may enjoy segmenting this heterogeneous market into homogeneous groups on which it concentrates its resources in order to achieve more favourable results and thus to succeed. However, for a segmentation strategy to be competitively effective and efficient, the profits gained from it should compensate the costs (Wind and Douglas, 1972: 17).

Furthermore, as discussed by Wind and Douglas (1972), international segmentation strategy may overcome misconception problems that arise from generalization and simplification of global market demands due to their unknown and miscellaneous conditions. While segmenting a foreign market, companies need extensive research on differences and similarities inside that market. This, in turn, will lead to a better grasp of customer characteristics and needs eliminating the consequences of lack of knowledge.

From an economic standpoint, the application of price discrimination – different product price for each different segment according to the price elasticity of demand in that segment – provides companies to charge higher prices to consumers with low-price-elasticity leading the way to profit maximization and thus to a better advantage to compete in global terms. Airline companies such as Turkish Airlines and British Airlines enjoy the benefits of segmenting their customers according to their price sensitiveness and other distinguishing characteristics. These companies charge different prices not only for each customer category but also even for different days and seasons. The effectiveness of price elasticity as a crucial segmentation criterion is further conceptualized by Frank and Massy (1965) with regard to its strategic managerial importance in evaluating market segments.

Ultimately, international market segmentation offers a significant solution to the debate on whether to standardize or to customize (to adapt) (Baalbaki and Malhotra, 1993; Steenkamp and Hofstede, 2002). Instead of targeting the whole world market with a standardized marketing strategy, companies segment the markets according to their similarity with regard to their likely response to the specific marketing mix being offered. This means not only standardization in the sense that each segment is served with a uniform strategy but also customization since this uniform strategy is adapted according to the segment characteristics and differentiated across countries. Therefore, it can be suggested that the advantages of both standardization (e.g. lower costs, better quality) and customization (e.g. meeting the needs of consumers closely) is obtained by making use of the international market segmentation strategies (Steenkamp and Hofstede, 2002: 186).

# FOCUS or NOT to FOCUS

Within the international market segmentation, two diverse strategies are possible: the *multi-segment approach* and the *focus strategy*. Each of them is applicable to different sized companies and has its own advantages.

Companies that have chosen the *multi-segment approach* serve to multiple segments by offering distinct marketing mix to each (Ferrell et al., 1998: 94). Due to high costs associated with developing multiple strategies, mostly medium- to large-sized companies prefer to use this alternative (Ferrell et al., 1998: 94). By engaging in multiple segments, they may have the benefit of the increased shares and brand awareness in the global market. Moreover, the 'synergies' created between segment offerings attract the attention of companies (Aaker, 2001: 47). For instance, in the automobile industry, the image developed by General Motors in the high end has an effect on the sales in the price-conscious end. In other words, a company that is successful at the high end can exploit that success at the low end (Aaker, 2001: 47). Obviously, the reverse should be expected for a weak company. Finally, in financial terms, companies may reduce their risk since gain in one segment will compensate the loss in the other. This possibility will further balance, to some extent, the economic instability faced by companies due to continuous change in global market circumstances.

The other option to compete globally is the *focus strategy* that is concentrating only on a single segment of the market. Since it avoids 'strategy dilution and distraction', Aaker (2001) suggests that companies by specialization may enjoy likely benefits of it. Companies focus all its economic, organizational and knowledge sources on understanding and evaluating a single segment. Hence, this will result in a better grasp of the needs and desires of that specific segment. From a different angle, specialization can also be considered as the major drawback since it means 'putting all the eggs in one basket' (Ferrell et al., 1998: 94). By doing so, companies can be exposed to risks resulting from unpredictable economic environment and changing segment characteristics. Finally, Aaker (2001) advocates another advantage of a focus strategy as a positioning devise in the sense that companies may enhance their identities with an 'exclusive image' as in the case of some textile firms – Calvin Klein and Donna Karran that are competing only in very high end of the global market.

These two strategies – multi-segment and focus – are two different sides of the same coin; therefore, the quest for an exact resolution about either to focus or not to focus will be left half-finished. The fact that mere focus on a single segment may limit the company potential and thus its competitive advantage in some product markets, in others it may serve as the only option to stay alive globally. The same reasoning is also plausible for multi-segment strategy.

# DYNAMIC SEGMENTATION

World market place is affected by various factors that lead to alteration in its conditions. Change in technology reinforce the interaction and communication between people and increase the organizational capabilities. Instability in micro- and macro-economic conditions creates a volatile social environment. In response, customers and competitors react accordingly and adjust their preferences. Likely, market segments go through a continuous change process, partly visible and invisible. Specifically, customers' changing needs and evolving preferences render a firm's target segments unstable resulting in *segment instability* (Blocker and Flint, 2007). This is a difficult challenge for strategic management area and manifests itself in two important ways. First, what is valued in a segment may change, termed *customer desired value change* (Blocker and Flint, 2007: 811). It results especially in segments where there is a continuous and rapid innovation as is the case in IT sector. Second, customers may move into one segment and fall out of another thus customer quantity and revenue in a segment increase or decrease affecting the *segment membership*. Thus, segment instability might blur the picture on which segments deserve greater focus and until when they are relevant.

Hence, companies in order to ensure success should take action by consistently reviewing and revising their segmentation strategies periodically – although there is no best time to do so – according to the critical trends and opportunities in the market (Adcock, 2000: 112). 'Flexible responsiveness' to possible changes in customer motivations is extremely crucial in terms of maintaining the relevance of segmentation processes (Doyle and Saunders, 1985; Adcock, 2000). Finally, the causal influences should be analyzed to forecast the likelihood of future changes. Only then, will the unpredictable future gain some meaning to originate competitive global strategies.

"In 2003, IBM Institute for Business Value carried out a study that consists of online surveys sent to 2,000 executives in marketing and sales in companies with over US$100m in annual revenue. In addition, in-dept interviews were carried out with 15 executives. It has been observed that the companies studied emphasize mostly the importance of dynamic segmentation approach. The study founds out that market segmentation is no longer a simple, or static marketing technique. Depending on the goal, segmentation can be simple or complex, strategic or tactical, one dimensional or multi-faceted" (Badgett and Stone, 2004).

## THE VAGUE PICTURE

Besides its importance and attractiveness in theoretical and managerial terms, the logic of segmentation suffers from a high degree of ambiguity. The dilemma is about how to find the best way to segment markets; however, no single best way exists (Adcock, 2000: 107). Each recommended approach not only in its own sense has some benefits but also when compared to others has some weaknesses in particular instances. It is almost impossible to prove that the chosen criterion is the best. Looking at the marketing literature, many models are proposed to support different ways to segment markets. Traditionally, geographic, demographic, psychographic and behavioural bases appear to be the most widely used standards for segmenting the consumer markets, however, in international segmentation; a further dimension – general and situation-specific country characteristics – has to be considered (Wind and Douglas, 1972: 18; Nachum, 1994: 54). Moreover, Doole and Lowe (1997) suggest a cross-cultural segmentation since segmenting purely by country and geographical factors will ignore the differences between customers within a country. Bock and Uncles (2002) focuses on the customers by forming a taxonomy of generic differences between them. What they argue is that by recognising these distinct types of consumer heterogeneity, firms can identify the relevant profitable segmentation variables and methods. On the other hand, Baalbaki and Malhotra (1993) offer a different view in the sense that environmental bases (geographic, political, economic or cultural) should be used simultaneously with marketing management bases (product-, promotion-, price- and distribution-related). Besides, some simple checklist of effective segmentation is presented by Kotler referring to segment measurability, accessibility, actionability and sustainability (Dibb, 1999: 108). Although, later, other points such as segment effectiveness, identifiability, potentiality, profitability, responsiveness and stability are added by many others, company managers experience implementation difficulties when putting theory into practice since more structured guidelines are needed (Crittenden et al., 2002: 17; Dibb, 1999: 117, Steenkamp and Hofstede, 2002: 196; Lehmann and Winer, 2002: 130). Four main barriers to implementation are identified by Palmer and Millier (2004: 779): the context dependent nature of segmentation, the dynamic interaction between products, customers and the market-place, the difficult and demanding nature of the segmentation process and the importance of implementation.

Bonoma and Shapiro (1984) suggest that the theoretically desirable is not analogous to the managerially possible; therefore, managers experience a ‘segmentation tension’. To overcome this strain, there should be an overlap between the two while deciding on which segmentation scheme to use. Moreover, in defining segments several different schemes should be used in combination to achieve competitive success. Nonetheless, this process will involve trial and error and may result in imprecise consequences in reality. Palmer and Millier (2004: 780) suggest the concept of *managerial intuition,* defined as data collected through experience, to be used in the segmentation process. However, they also recognize the limitations of over relying on intuition in the sense that if the intuitive knowledge and insights of managers gain presence over the process, it runs the risk of ignoring market place data that are relevant and may suggest alternative solutions (Palmer and Millier, 2004).

International market segmentation process may be resembled to a contemporary fine art. One has offered all the colours to do the painting. However, the end picture will depend on both the imagination and experience of the painter and how these colours are used in combination. In addition, far from expected, the targeted audience will interpret and react to this vague picture in different and complex ways. Paul Fifield has summed this up:

*“Market segmentation, dealing as it does with people as its raw material, cannot and should not be approached in a purely scientific manner. The only workable long-term segmentation basis comes from the*

*market place, not from our own wishful planning. … The process, like marketing itself, is necessarily long, messy, intuitive and fraught with danger for the logically minded." (Adcock, 2000: 108)*

# CONCLUSION

International market segmentation is both a strategic and a tactical initiative that is being enjoyed by most of the today's work organizations to succeed in global competition. It not only alerts companies about where to concentrate their resources effectively by identifying profitable customers but also encourages them to understand the competitive market deeply. Customers are too numerous and varied in their needs and tastes to be satisfied by a single global offering (Dibb, 2001). In an attempt to satisfy this heterogeneity, companies either engage in multiple-segmentation or focus only in one segment. Whichever strategy is chosen, due to the increasing complexity, variety and diversity in the world market place, periodical review and revision is required to stay dynamic and to catch up the new phase. In the international marketing literature, there are various alternatives offered to segment markets; nevertheless, it is impossible to offer a single right way for segmenting a market. In the side of the companies, the effects of this have been most marked in terms of experiencing implementation difficulties. It is suggested that while segmenting markets, managerial intuition and experience that gives credit to dynamic segmentation shall also be recognized instead of approaching in a purely logical manner.

As a result, the dynamic market place and in return the dynamic segment characteristics problematise the scene by creating a vague picture that is highly creative and intuitive. Therefore, international market segmentation by itself is not a full guarantee to survive in this competitive environment. It also requires companies to be determinant to cope with these complex uncertainties continuously, in their survival attempt.

Finally, in terms of recognising the limitations of this study itself, a large scale and/or a cross-cultural empirical research shall be conducted with different theoretical positions to validate the propositions advocated in this research and to understand what really lies beneath the international segmentation process in practice. Scientifically testing or qualitatively validating the propositions of this study might allow constructing a clearer and richer picture, if not finished, for the *segmentation process* and its effectiveness for strategic management.

# REFERENCES


Aaker, D.A. (2001), *Strategic Market Management*, USA: John Wiley&Sons

Adcock, D. (2000), *Marketing Strategies for Competitive Advantage*, Chichester : J. Wiley

Baalbaki, I.B. and Malhotra, N.K. (1993) 'Marketing Management Bases for International Market Segmentation: An Alternate Look at the Standardization/Customization Debate', *International Marketing Review*, Volume 10 (1), pp: 19-44

Badgett, M. and Stone, M. (2004), Multidimensional segmentation at work: Driving an operational model that integrates customer segmentation customer management, *Journal of Targeting, Measurement and Analysis for Marketing,* Vol. 13, 2, pp. 103–121

Blocker, C.P. and Flint D.J. (2007), 'Customer Segments as Moving Targets: Integrating Customer Value Dynamism into Segment Instability Logic', *Industrial Marketing Management*, Volume 36, pp: 810-822

Bock, T. and Uncles, M. (2002) 'A Taxonomy of Differences between Consumers for Market Segmentation', *International Journal of Research in Marketing*, Volume 19, pp: 215-224

Bonoma, T.V. and Shapiro, B.P. (1984), 'Evaluating Market Segmentation Approaches', *International Marketing Management*, Volume 13, pp: 257-268

Craft, S.H. (2004), 'The International Consumer Market Segmentation Managerial Decision Making Process', *SAM Advanced Management Journal*, Summer 2004, pp: 40-46

Crittenden, V.L., Crittenden, W.F. and Muzyka, D.F. (2002) 'Segmenting the Business-to-Business Marketplace by Product Attributes and the Decision Process', *Journal of Strategic Marketing*, Volume 10, pp: 3-20

Dibb, S. (1999) 'Criteria Guiding Segmentation Implementation: Reviewing the Evidence', *Journal of Strategic Marketing*, Volume 7, pp: 107-129

Dibb, S. (2001), 'New Millennium, New Segments: Moving Towards the Segment of One?', *Journal of Strategic Marketing*, Volume 9, pp: 193-213

Dickson, P.R. and Ginter, J.L. (1987) 'Market Segmentation, Product Differentiation and Marketing Strategy', *Journal of Marketing*, Volume 51, pp: 1-10

Doole, I. and Lowe, R. (1997), *International Marketing Strategy: Contemporary Readings*, Vicenza, Italy: International Thompson Business Press

Doyle, P. and Saunders, J. (1985) 'Market Segmentation and Positioning in Specialized Industrial Markets', *Journal of Marketing*, Volume 49, pp: 24-32

Ferrell, O.C., Hartline, M.D, Lucas Jr. G.H. and Luck, D. (1998), *Marketing Strategy,* USA: Harcourt Brace&Company

Frank, R.E. and Massy, W.F. (1965), 'Market Segmentation and the Effectiveness of a Brand's Price and Dealing Policies', *The Journal of Business*, Volume 38 (2), pp: 186-200

Lehmann, D.R and Winer, R.S. (2002), *Analysis for Marketing Planning*, Boston, Mass: McGraw-Hill Irwin

Levitt, T. (1960), 'Marketing Myopia', *Harvard Business Review*, July-August, pp: 45-56

Levitt, T. (1968), *Innovation in Marketing: New Perspectives for Profit and Growth,* London: Pan Books,

Maynard, M. and Tian Y. (2004), 'Between Global and Glocal: Content Analysis of the Chinese Web Sites of the 100 Top Global Brands', *Public Relations Review*, Volume 30, pp: 285-291

Mesdag, M.V. (2000), 'Culture-sensitive adaptation or global standardization – the Duration-of-usage Hypothesis', *International Marketing Review*, Volume 17 (1), pp: 74-84

Nachum, L. (1994), 'The Choice of Variables for Segmentation of the International Market', *International Marketing Review*, Volume 11 (3), pp: 54-67

Palmer, R.A. and Millier, P. (2004), 'Segmentation: Identification, Intuition and Implementation', *Industrial Marketing Management*, Volume 33, pp: 779-785

Steenkamp, J.E.M and Hofstede, F.T. (2002) 'International Market Segmentation: Issues and Perspectives', *International Journal of Research in Marketing*, Volume 19, pp: 185-213

Wind, Y. and Douglas, S.P. (1972), 'International Market Segmentation', *European Journal of Marketing*, Volume 6 (1), pp: 17-25

# STRATEGIC BRAND MANAGEMENT IN HOSPITALITY SECTOR:HOW TO MANAGE CO-BRANDING IN HOTELS AND RESTAURANTS

**B. Ruhet Genç**
**Beykent University, Turkey**

## ABSTRACT

*Companies in the hospitality sector (hotels, restaurants etc.) aim to distinguish their brand image and differentiate their product or service among the competitors by adopting particular brand strategies since identifying a target customer base and understanding their needs and preferences are of primary significance for hospitality firms. The achievement of a distinguished designation necessitates utilizing research based and strategic branding techniques and suggestions. One major branding strategy particularly for international firms is co-branding. Nevertheless, there are scarce studies which examine the role of strategic co-brand management in the hospitality sector. This review paper aims to critically discuss the current position of strategic co-branding in the hospitality sector and possible problems involved in this issue. Recommendations for future research on co-branding of hospitality firms within the strategic management paradigm are provided. Furthermore, managers in the hospitality sector are given suggestions for enhancing strategic management of co-branding in hospitality and particularly in destination firms.*

*Key words: Co-branding, brand management, hospitality, hotels and restaurants, strategic applications.*

## INTRODUCTION

In recent years, many hospitality, hotel and restaurant firms have realized the strategic importance of co-branding (Lee et al., 2006). Particularly, some hotels face with diminished marginal profit from F & B. International hotels have started to utilize co-branding applications and strategies, such as making alliance with a prominent restaurant chain, to decrease these problems. Strategic management of branding in the hospitality sector is very critical, given that firms in the hospitality sector are involved in a competitive tourism market and hence deals with strong rivals (Walsh, 2002).

Companies in the hospitality sector (hotels, restaurants etc.) prioritize research-based branding to a specific customer target group in order to consolidate an outstanding corporate identity and service quality (Morgan, Pritchard and Pride, 2004). They aim to distinguish their brand image and differentiate their product or service among the competitors by adopting particular brand strategies since identifying a target customer base and understanding their needs and preferences are of primary significance for hospitality firms.

Customers of hospitality firms usually give importance to image, quality and prestige of the services or products in their decision making processes. The achievement of a distinguished designation necessitates utilizing research based and strategic branding techniques and suggestions. One major branding strategy particularly for international firms is co-branding (Knowles, Diamentis and El-Mourhabi, 2008). Nevertheless, there are scarce studies which examine the role of strategic co-brand management in the hospitality sector. This review paper aims to critically discuss the current position of strategic co-branding in the hospitality sector and possible problems involved in this issue. Recommendations for future research on co-branding of hospitality firms within the strategic management paradigm are provided. Furthermore, managers in the hospitality sector are given suggestions for enhancing strategic management of co-branding in hospitality and particularly in destination firms.

# BRANDING AND CO-BRANDING IN THE HOSPITALITY SECTOR

## What Is Branding and Co-branding?

The conceptualization of the term “brand” is not uniform and several definitions of brand have been suggested in the literature. According to Mellerowicz (1998, p.784), brand is “a landmark of a given product which symbolizes its consistent quality, size and amount”. In marketplace, a product or service is usually identified by one of its properties or qualities. Customers choose to buy a service or product depending on a distinctive quality or property of it (Panda, 2006). Brands can be regarded as functional tools to create and consolidate an image, to diminish risks in a competitive market environment and to make efficient use of information dissemination in the hospitality industry (Riesenbeck and Perrey, 2009). Thus, firms in the hospitality sector can realize their current position in the market place and generate new potentials by identifying their customers’ view of and impression about their firms, and by analyzing the branding process in which they become identified with an image.

Branding can provide security to the hospitality firms. Hospitality firms can enhance decision making processes in favor of their brands by eliminating the risk of adverse decisions. Besides, in tourism and hospitality industry, how information and image conveyed to potential customers and how customers perceive the tourism and hospitality firms’ services can be directly affected by brand images (Riesenbeck and Perrey, 2009). With branding, hospitality firms can inform customers about their services and products in an efficient way.

Branding, as the symbol of a firm’s image and quality, has an informational function in that through branding, a firm introduces its services and promotes its quality in the eyes of the customers. This informational role facilitates customers’ sense of security for a company since a brand familiarizes customers with the characteristics of a service/product, assures a predictable pattern of service and level of quality and provides plain information about the brand. Therefore, branding functions as a reference point which ensures security of a familiar brand image and comforts customers through reducing feelings of uncertainty and ambiguity in the contemporary world of business and travel.

Branding has been demonstrated to be directly related to customer loyalty (Olsen, West and Ching-Ying Tse, 1998). The symbol of a product or service quality and the representation of its standards and value are conveyed through brands. Hence, brands provide information to customers on the properties of a product or service, which are designed to match with the customers’ demands. It also aids customers to become less ambivalent about selecting a given product type or service since brands facilitate differentiation of specific products/services in the marketplace.

One study investigated competitive methods of the multinational hotel firms in the tourism industry between 1985 and 1994 (Olsen and Zhao, 1997). This was a comprehensive research that utilized content analysis of articles and reports published in the hospitality industry. Results indicated that one of the major competitive methods was branding. Branding method was found to be utilized by the association of a hotel firm’s product with a special offer, service or product. By branding, hotel firms aimed to provide new services to the tourist and hotel customers. An updated version of this study demonstrated that between 1994 and 1996 hotel firms utilized brand positioning method for gaining competitive advantage (Olsen and Zhao, 1997). Hotel firms seemed to clarify brand identity of products or services and differentiate one product or service of a given brand both from competing alternatives and from firms’ other products or services.

According to classical brand theory, one strategy for gaining competitive advantage is forming a sole grand brand that has large customer recognition and market share (Muller, 2005). Pizza Hut and Kentucky Fried Chicken utilize this strategy – they stand on their own by their brand image, and provide products and services in the competitive market environment. Nevertheless, strategic shift in the hospitality sector especially in the last 20 years paves the way for brand alliances –that is co-branding - among hospitality firms.

Hospitality firms can utilize several branding strategies for establishing powerful brand equity (Knowles, et al., 2008). Brand equity involves assumption and beliefs of consumers about a given hotel or restaurant brand (brand image) as well as their emotional bond and preference of a given brand (brand loyalty). A well-known branding strategy for enhancing brand equity is co-branding.

Co-branding involves strategic alliance of at least two firms (Knowles, et al., 2008). It is differentiation of a product or service image by using at least two different brand images (Lee and Reinhold, 2008). Co-branding is usually defined as "a form of cooperation between two or more brands with significant customer recognition, in which all the participants' brand names are retained" (Blackett and Boad, 1999) (see, Figure 1). Joint venture co-branding involves such definition (Kotler and Keller, 2006). One example of joint venture co-branding is Sony-Ericsson mobile phones. In some conditions, co-branding might involve a combination of two or more brands to form a new product or service with a new brand identity (Park, June and Shocker, 1996). Or, one brand utilizes a branded ingredient as a marketing strategy (Norris, 1992). Intel-inside is one example of such ingredient co-branding.

## Common Examples of Co-branding

The early examples of co-branding are observed in the USA in early 1930's, such as Bergen's restaurants and hotels. The hotel and restaurant industry consulted to co-branding when faced with unprofitable sales and poor management of sales (Boone, 1997). Today many chain hotels and restaurants strategically utilize co-branding with the aim of enhancing distribution of products or services to customers as well as increasing the scope of customers to achieve profitability (Boone, 1997).

Marriott Hotels is one of the examples which form a highly recognized restaurant chain after co-branding with Pizza Hut. Another widely known example is that Sheraton co-brands with Starbucks' coffee, France baked goods and Robert Mondavi Wines. Similarly, Carlson Country Inn co-brands with Country Kitchen, Italianni's, TGI Friday's; Choice Hotel co-brands with Pizza Hut, The Garden Place, Nestle Toll House Café, Coca Cola; Hilton, with Benihana. Related brand alliances are formed between Holiday Inn and Little Cessar's Pizza, Red Lobster, Elephant and Castle, Good Eats' Grill. In co-branding, usually two firms collaborate on the public image of their brands. For instance, in order to handle decreasing profit margins from hospitality services, Marriott and Hyatt collaborated by co-branding in hotel industry (Oh, 2008).

## The Mechanism of Co-branding

Branding and co-branding involve the basic learning principles of human beings, such as classical conditioning (Panda, 2006). In classical conditioning, one associates a neutral stimulus (that does not induce a biological response in the person) with a stimulus that stimulates a natural response in the person. After successive associations of the latter stimulus with a neutral one, the person starts to give a similar natural response to the neutral stimulus in the absence of the natural stimulus. For instance, during child development, the word "lemon" is successively associated with the image, taste and smell of lemon. We tasted lemon and heard the word lemon many times. For many people, the word lemon starts to induce the source taste of lemon – a natural response to lemon – even though they do not actually taste it. Hence, the image and word lemon acquire the power of inducing a similar natural response to an actual stimulus (lemon's taste itself).

This principle applies to formation of branding and co-branding: we learn to associate a quality of a product with its brand name. After successive associations, the personal experience or observed experience with that product or service (through advertising or observation of others' behaviors) is associated with the brand name or image (which is a neutral stimulus). If the personal experience of the product or service is positive, people develop a favorable attitude toward the brand name or image, or vice versa.

In the case of co-branding, another neutral stimulus (a brand image of a company) is associated with another brand image, on which people have already formed a certain attitude. Through this mechanism, a new meaning or quality can be attributable to the product or service by the advertiser or image maker. In other words, through co-branding, the psychological impact of a service of product in the eyes of customers is managed and enhanced.

# STRATEGIC USE OF CO-BRANDING IN BRAND MANAGEMENT FOR INTERNATIONAL HOTELS AND RESTAURANTS

Strategic management is defined as the "art and science of formulating, implementing, and evaluating, cross-functional decisions that enable an organization to achieve its objectives" (Fred, 2009). In general, strategic management involves several steps: at the initial step, the goals and aims of the company are defined (Eren, 2003). At the second stage, managers should analyze the strengths and weaknesses of the firm, and possible threats from the marketplace. At the third stage, the company is localized in accordance with its internal and external conditions. Then, organization-wide, department-based and worker-based strategies are respectively developed. Sources of the company are distributed in accord to these developed strategies. At later stages, company should revise its vision, aim and scope as well as leadership style in line with recent organizational strategies. Even the organizational culture might be changed in congruence with these strategies. Continuous monitoring and regular improvement of these strategies provide dynamic management in a company (Eren, 2003).

According to British brand consulting group (Interbrand, 2008), the ranking of top 100 global hotel and restaurant brands in 2008 is as following: McDonald's with 31,049 dollar brand value (8$^{th}$), KFC with 5,582 dollar (64$^{th}$), Pizza Hut with 4,097 dollar (81$^{th}$), Starbucks 3,879 dollar (85$^{th}$) and Marriott 3,502 (96$^{th}$). Former three restaurant brands were still in the ranking in 2005, Marriott hotel entered the list in 2008. These ranks are very surprising in the sense that despite many hotel firms are known to be prominent across countries, none of them have brand value larger than 2.7 billion dollar (Oh and Pizam, 2007). These data indicated that although hotel firms and many restaurant firms utilize different branding strategies, they need to adopt different strategies for branding, such as co-branding.

## Benefits of Co-branding Management

There are several managerial, economical and marketing advantages of co-branding in the hospitality sector. One of them is the creation of a powerful brand image for customers (Panda, 2006), which enhances the competitive advantage of the firm via maintenance of the brand image and distinguishes quality of the product or service from others in the marketplace. Hence, consumers can easily recognize a brand through co-branding strategies.

Co-branding is achieved through collaboration of two firms and alliances. Alliance provides opportunity to share costs of operations, branding and marketing (Muller, 2005). Production costs, marketing based costs, investment costs along with risk of competition in the marketplace can be diminished. Besides, with the help of co-branding, hospitality firms can launch business in new markets without any cost of the new brand (Kippenberger, 2000). One study reported that 10 % increase in the profit of Best Western is attributable to co-branding with Country Kitchen restaurant (Walkup, 1995). Similarly, another study showed that co-branding has provided substantial short term financial advantage to the hotel and restaurant firms (see, Table 1) (Boone, 1997).

**Table 1. Financial Advantage of Co-branding to Hotel and Restaurants**

| **Financial variables (on average)** | |
|---|---|
| Investment on branding | 1,290,000 dollars |
| Hotel average daily rate increase | 13 % |
| Hotel occupancy increase | 6 % |
| Hotel net income increase | 3.4 % |
| Restaurant revenue increase | 57 % |
| Difference in annual revenue between branded concept in hotel and system unit average | -27 % |
| Increase in restaurant net profit after replacement with branded concept | 220 % |

Source (adapted from): Boone, 1997

In co-branding, firms aim to increase their brand value in the eyes of customers. Customers' attitudes toward each brand, their reaction to co-branding of two firms and their attitudinal change after co-branding are critical for the competitive success of the firm (Simonin and Ruth, 1998). It was found that consumers usually give importance to co-brands and become loyal to specific firms due to their perception of co-branded products or services as having high quality (McCarthy and Norris, 1999).

One study examined the customers' post-purchase behaviors (i.e. brand loyalty, purchase patterns, frequency of visits, expenditure per person) in a family restaurant that utilized co-branding (Lee, Kim and Kim, 2005). Researchers found that particularly customer loyalty is significantly higher in co-branded family restaurants, compared to non-co-branded ones. Moreover, co-branding gives hotels and restaurant managers the opportunity to utilize expertise of the other brands (Muller, 2005) and hence increase the strategic use of branding.

Co-branding influences how a company or a service/product is perceived and evaluated by customers. Through co-branding, hospitality firms can have the chance to appeal to a diversified customer base, enhance their communicative strengths and enlarge their target customer group since brands of the allied firms have already been recognized by a particular group of customers. When two companies co-brand, their target customer groups merge and get acquainted with another and previously unrecognized brand name which is associated with their regular choices. Hence, co-branding facilitates customers' feelings of security for both brands, facilitates decision making and may secure a broadened customer target group.

One study investigated the strategic benefits of co-branding for hotel and restaurant firms from a managerial perspective (Boone, 1997). According to reports of 12 hotel managers, co-branding with restaurants is beneficial, because;

1. co-branding leads customers to prefer hotels due to perceived low risk, increased recognition of the hotels' brand with the aid of branded restaurants,
2. co-branded restaurants have branding and operational expertise, which can be utilized by these managers (such as training, consistency etc.),
3. co-branding with restaurants provides a flow of customers within the hotel setting
4. the total expenses of the hotel decrease and total profits increase,
5. restaurants' marketing strategies and outcomes positively influence brand recognition and image of the hotel,
6. co-branded hotels and restaurants share daily operational problems especially on food and beverages,
7. co-branded hotels offer wider food and beverage options to its customers (Muller, 2005).

Boone (1997) reported that managers of restaurant viewed co-branding as advantageous, because;

1. co-branding provides opportunity to distribute restaurants on strategically good locations,
2. managers can get benefits from the flow of hotel customers

Despite its advantages, co-branding strategies do not directly lead to success in the market (Panda, 2006). A hospitality firm needs to accompany empirical research findings to obtain successful brand-brand associations. According to Boo and Mattila (2002), co-branding is related to customers' motivations and characteristics, characteristics of collaborating partners as well as customers' perception of the brand collaboration of two firms. It has been argued that customers' view on the brand alliance is important, because it has an impact on how they evaluate the value of the brand of products/services (Bob and Matilla, 2002), their satisfaction and motivation to repurchase the same products/services. Ashton(2008) stated that particularly in hotel and restaurant industry, customers have a direct experience with the brand of a hotel or restaurant and confront with the outcomes of co-branding of hotels and restaurants by frequent exposure to information on brand image and identity.

## Problems in Co-branding Management

There are some problems involved in co-branding management. Boone (1997) found that for hotel managers, these problems are;

1. scantiness of the available space and strictness in image of the setting/offered menus
2. decline in food and beverage services of the hotel's itself
3. long and costly worker training programs,
4. operational conflicts between hotel managers and restaurant managers.

From restaurant managers' perspective, problems of co-branding between hotels and restaurants were reported as following:

1. limited investment of hotels on branding
2. inadequate/unsatisfactory spaces or sites for restaurants within the hotel environment
3. hotel managers' lack of understanding and experience on the hotel restaurant concept and operations.

Co-branding strategies and strategic management of co-branding is essential, because two collaborator firms have their own core values and thus brand values (Motion, Leitch and Brodie, 2003). Collaborator firms might have problems during co-branding due to different corporate core values (Motion, Leitch and Brodie, 2003) or differences in managerial perspectives of hotels and restaurants.

Another major problem involved in branding of hospitality firms is effective communication of brand qualities and characteristics to the targeted consumers (Higley, 2001). One hotel or restaurant might determine its brand identity (that is, brands' derivative meanings and characteristics and what information the brand conveys by its product or service) (Nykiel, 1989). However, it might not communicate the brand identity in an effective way to the customers. Moreover, a brand awareness of a hotel or restaurant might not be adequate. In other words, customers might not be aware of the presence of a brand.

Hence, although brand identity is solidly presented, customer may not be aware of the presence of a brand, they may not know much about the hidden message of the brand. These problems could be overcome through aggressive advertising and media. Brand identity and image of a service or product could be conveyed via media, which increases the brand awareness and differentiation of a product or service from others in the hospitality market.

## Strategic Applications for Co-branding in International Hotels and Restaurants

There are mainly four strategic applications of co-branding (Begeman, 2008): reaching in, reaching out, reaching up and reaching beyond (Leuthesser, Kohli and Suri, 2003, p. 40). Basing on whether target market is newly developed or existing market, and whether two brands are necessary for product functioning or not co-branding companies can utilize one of these strategies. A hotel or restaurant company can use reaching up strategy, when partner's brand image (not product quality) adds to the co-brand image. Reaching out strategy is implemented if co-brand has benefits for product itself, such as entering new market and not for brand qualities. Hence once target market is new, reaching out strategy for co-branding can be utilized. When co-brand can contribute company's brand image as well as entering new market, reaching beyond strategy can be implemented (Leuthesser, Kohli and Suri, 2003). The last co-branding strategy is reaching in. Ingredient co-branding is one example of this strategy. This strategy is used when company wants to enhance core benefits of its product.

Despite aggressive advertising and media, brand image of a service or product can become similar to other brands in the long term (Panda, 2006). Hence, the long term maintenance of a brand is required. This can be achieved through strategic brand management. With respect to strategic brand management, three strategies should be aimed for long term brand value and brand image maintenance. These are;

- branding for a product/service by emphasizing its distinct qualities,
- differentiation of the brand's position from other brands' in the marketplace,
- continuous evaluation of the strategic position of the brand in the marketplace.

Moreover, hospitality firms can utilize information technologies to strategically manage co-branding (Kotler and Armstrong, 2001). For example, with the help of internet, hotels or restaurants can reach customers that match with the targeted ideal customers. The characteristics and profiling of customers can be searched via internet and specific databases. These target groups can be informed about new offers or opportunities. Another example is monitoring the changing needs of customers through targeted promotions (Oliva, 2001).

Moreover, frequent visitors can also be contacted via internet and databases. They can be reached in their special dates or given special offers in accordance with their previous preferences. In this way, hospitality firms can enhance customer loyalty and branding at the same time. Besides, via internet and online services, hospitality firms can advertise their services and products and enhance their brand image for a longer duration of time, compared to advertisements appearing on newspapers, TV or radio. By online advertisement, the brand image and brand identity can be clearly and correctly conveyed to customers (McCasland, 2003).

# SUGGESTIONS AND CONCLUSION

Co-branding is a good strategy for effective marketing and particularly establishment of customer loyalty in hotel and restaurant sector (Lee et al., 2005). However, co-branding gives way to diminishing returns per customers, which results in marginal profit reductions. Hence, co-branding should not be utilized for long term quality maintenance. In order to handle these challenges, managers of hospitality firms need to adopt strategies for successful co-branding. Strategic thinking in co-branding also allows the transfer of co-brand image and message from firms to customers (Balmer, 2001). In this way, the co-brand can be more easily differentiated from other brands. Moreover, with strategic management of co-branding, customers' commitment and loyalty to the brands are enhanced.

For strategic co-branding management, hotel managers should (Boone, 1997);

- perceive restaurant co-branding as a partner, rather than a guest in the hotel
- join hotel managers to strategic decision making processes about hotel's important issues, such as spatial settings of restaurant, common training programs, operational synchronistic,
- invest on the brand image, co-branded identity and brand quality (such as, quality product, efficient procurement and delivery system)

Hotel managers can also utilize the help of consultants for co-branding with a restaurant.

Restaurant managers can accomplish following strategies for successful co-branding management (Boone, 1997);

- flexible operations and branding of a restaurant should go hand in hand with hotel's operations and standards, such as spatial arrangements, training, timing of operations,
- co-branding with hotels which overlap with the brand concept of the restaurants should be emphasized for enhanced recognition and clear message to customers about the brand identity of the restaurant.
- benefits of co-branding, such as free benefits (e.g., complementary food or drinks with co-brand), discount benefit (e.g. discount on prices), intangible benefits (e.g. online newsletters), gifts, samples etc. should be enhanced, which could further support the customer loyalty to the restaurant's brand (Lee et al., 2005).
- thoughts and evaluations of customers on co-branding activities in restaurants should be recognized and taken into account (Lee et al., 2005).

Further empirical investigation of branding in hotel and restaurant management is needed. There are several research questions that can be targeted in future studies (Oh and Pizam, 2007):

- Strategies for how and at what frequency to measure brand equity of hotel and restaurant firms,
- Perceptions and beliefs of brand managers about strategic brand alliances,
- The attitudes of international customers on co-branding of hotel and restaurant firms and how they effect their purchase behavior, satisfaction and brand loyalty,
- The saturation level of customers to the hotel and restaurant brands and the measurement of this level.

# REFERENCES


*1.* Ashton, A (2008). Hotel-restaurant co-branding.: The impact of consumer evaluation on perceived risk, perceived value and intention to purchase. *Paper presented at CAUTHE conference, Australia.*
2. Balmer, J.M.T. (2001b). The three virtues and seven deadly sins of corporate brand management. *Journal of General* Management*, Vol. 27*,1-17.
3. Boone, J. M. (1997). Hotel-restaurant co-branding: A preliminary study. *Cornell Hotel and Restaurant Administration Quarterly, Vol 38*, 34-43.
4. Walkup, C. (1995). Carlson launches triple- branded hotel restaurant complex. *Nation's Restaurant News, Vol 9*, p. 1.
5. Higley, J. (2001). *Consultants Talk Recovery, Brands as Industry Resumes Conferences*, Retrieved 22 April 2009, from Hotel & Motel Management, http://www.findarticles.com/cf_0/m3072/20-216/81529794/html
6. Interbrand (2008). Best Global Brands. Retrieved in 20 May 2009, from http://www.interbrand.com/best_global_brands.aspx?langid=1000

7. Kippenberger, T. (2000). Co-branding as a new competitive weapon. *The Antidote, Vol 5,* 12-15.
8. Kotler, P., & Keller, K. L. (2006). Marketing Management (12th ed.). Upper Saddle River: Prentice Hall.
9. Knowles, T., Diamantis, D., El-Mourhabi, J.B. (2004). The globalization of tourism and hospitality: a strategic perspective. Cengage Learning.

10. McCasland, M. (2003). *Making brands relevant online (Part I),* Retrieved 20 April 2009 http://www.marketingprofs.com/3/mccasland8.asp.
11. Morgan N., Pritchard A., & Pride R. (2004), Destination Branding: Creating the Unique Destination Proposition. Butterworth-Heinemann.
12. Motion, J., Leitch, S., & Brodie, R.J. (2003). The case of adidas and the all blacks. *European Journal of Marketing, Vol 37*, 1080-1094.
13. Muller, C. (2005). The case for co-branding in restaurant segments. *Cornell Hotel and Restaurant Administration Quarterly, Vol 46*, 92-95.
14. Norris, D. G. (1992). Ingredient branding: A strategy option with multiple beneficiaries. *Journal of Consumer Marketing, Vol 9*, 19-31.
15. Nykiel A. R. (1989). Marketing In the Hospitality Industry (2nd edition). Van Nostrand Reinhold: New York.
16. Lee, C. L., & Reinhold, D. (2008). *A systematic analysis of the preference change in co-branding,* Retrieved 21 April 2009, from Munich Personal RePEc Archive, http://mpra.ub.uni-muenchen.de/12249/
17. Oh, H. and Pizzam, A. (2008). Handbook of Hospitality Marketing Management, Butterworth-Heinemann.
18. Oliva, R. (2001). *Getting Connected*, Retrieved 21 April 2009, http//www.findarticles.com/ef-dls/m3493/3-35/72131388/html
19. Olsen, M., West, J., & Ching-Ying Tse, E. (1998). Strategic Management in the Hospitality Industry (2nd ed ). John Wiley & Sons: New York.
20. Olsen, M. D., & Zhao, J. L. (1997). New management practice in the international hotel industry, *Travel and Tourism Analyst, Vol 1*, 53-73.
21. Panda, T.K. (2006). *Strategic advantage through successful co- branding.* Retrieved in 22 April 2009, dspace.iimk.ac.in/bitstream/2259/203/1/Strategic+Advantage+through++Successful+CoBranding.pdf.
22. Park, C.W., June, S.Y., & Shocker, A. D. (1996). Composite branding alliances: An investigation of extension and feedback effects. *Journal of Marketing Research, Vol 33*, 453-466.
23. Riesenbeck, H., & Perrey, J. (2009). Power Brands: Measuring, Making and Managing Brand Success. Wiley-VCH.
24. Simonin, B. L., & Ruth, J. A. (1998). Is a company known by the company it keeps?: Assessing the spillover effects of brand alliances on consumer brand attitudes. *Journal of Marketing Research, Vol 35*, 30-42.
25. Walsh P. J. (2002). *Brand Power*, Retrieved 24 April, 2009, from Hotel & Motel Management, http://www.findarticles.com/cf_0/m3072/8-217/87089728/html.

# INVESTIGATING DRIVERS OF CHOICE BEHAVIOR: CORPORATE IMAGE, PERCEIVED RISK AND TRUST INTERACTIONS THROUGH REPUTATION MANAGEMENT

**Huseyin Kanibir**
**EPOKA University, Albania**

**Sima Nart**
**Balikesir University, Turkey**

## ABSTRACT

*This study examines how reputation management (RM) activities influence consumers' choice behaviors. In order to understand the relationship between them the possible consequences of RM activities such as corporate image, consumer trust, and perceived risk were analyzed as the antecedents of consumers' choice behavior. Specifically, a structural equation model was developed for hypothesized relations between the constructs of the study. An empirical research was conducted by using data from 232 individual consumers in Albania (n=109) and Turkey (n=123) to test our conceptual model. The data were analyzed through t-test and structural equation modelling (SEM). The study shows that RM activities obviously determine the constructs of corporate image and consumer trust positively, whereas the perceived risk by consumers negatively.The lower level of perceived risk through RM activities was found as a significant determinant of consumers' choice behavior.*

*Keywords: Reputation management, choice behavior, consumer trust, image*

## INTRODUCTION

In marketing science, psychological processes behind consumer behaviors and preferences are accepted as key determinant based on vast body of research on their reactions to products, brands and the names of the firms. This understanding prescribes that general beliefs about a firm can determine the way in which consumers make their decisions toward the given firm. Also, marketing research mentions that the factor of consumer trust is another important key determinant in decision making process (Moorman et al., 1992; Chen and Tan, 2004). Both factors are the leading parts of psychological process although objective evaluations such as firm performance and quality of offerings are significant in arising of these two factors. If market players can manage succesfully the psychological processes of consumers, then they can able to increase the possibility to be chosen by consumers among many other competitors. This viewpoint builds a practical question for firms: what strategies and activities increase positively consumers' beliefs and trust toward the firm? This study examines reputation management activities from a perspective of increasing positive image of any firm and consumer trust to create choice behavior in favor of the firm.

Reputation has been defined as the intangible asset expressing the evaluation of target market on whether the firm is substantially 'good' or 'bad' (Weiss et al. 1999), and reflects the cumulative knowledge about the past and present acts of the organisation (Suh and Amine, 2007). In today's highly competitive markets, reputation is not a result that is appeared by itself, and that can be gained by chance. However, it is an organizational value that could be improved by management perspective with the long term strategies.

Shortly, creating a good reputation for a firm requires the understanding of strategic marketing management to transform these activities into reputation management.

Reputation gained by successful strategic marketing management can be demolished in very short run if the attention is not sustainable. Although reputation is an abstract concept, it has a potential to generate concrete values if it is created successfully by any firm. Fombrun (1996) states the meaning of positive reputation perceived by consumers for an organization in terms of competitive advantages as follows: (1) delaying rival mobility in the industry, (2) charging price premium on customers, at least in highly uncertain markets, (3) attracting higher-quality and larger amounts of investments from the stock market, (4) maintaining a high spirit among employees, (5) supporting and enhancing new product introduction and recovery strategies in the event of a crisis (Fombrun & Shanley, 1990; Fombrun, 1996).

However, although there is extensive research on reputation management (Weigelt and Camerer, 1988; Fombrun, 1996; Roberts and Dowling, 2002; Cretu and Brodie, 2007) the literature stil suffers from a lack of empirical studies that examine whether reputation management activities shift perceived risk by consumers through creating positive corporate image in the minds of consumers and establishing consumer trust. Therefore, the aim of this study is to explore the relationship between reputation management activities and consumers' choice behaviors through perceived corporate image, consumer trust, and perceived risk by consumers exposing to reputation management activities of firms. The knowledge this study generates is expected to contribute to the competitiveness topic of marketing literature by its research model considering the consequences of reputation management activities as the antecedents of choice behavior.

The rest of the paper is organized as follows: First, literature review is presented to recognize the main variables of the study. Second, we present a research model indicating the hypothesized relationships between constructs. Finally, methodology of the research, data analysis and findings will be presented, followed by a conclusion with the limitations of this research study.

# LITERATURE REVIEW AND DEVELOPMENT OF HYPOTHESES

## Reputation Management

Intensive competition, the most leading feature of today's markets, forces market players to find various strategic advantages. A widely accepted theory of the resource-based view of the firm (Barney, 1991) points out that valuable, rare, inimitable, and nonsubstitutable resources of the firms are essential for stronger and long-term competitiveness. It should be noted that the resources building competitiveness are not related only to production and technical processes such as R&D, efficiency, cost, but also related to managing the general psychology in the marketplace towards the firm. When consumers have negative associations for a firm then market performance of the firm probably will not be independent from them. In other words, what consumers, competitors, and related institutions of the market are saying about the firm is a directly part of market performance since the words have an obvious power to attract and discourage individuals into a given market player. Thus, reputation of any firm can play as rare, inimitable, and nonsubstitutable resource in a highly competitive market environment to encourage consumers toward the firm if it can be built successfully. Reputation of a firm, therefore, can be considered to be a psychological antecedent in consumer decision-making process. It is possible to consider this dimension as a leading strategic resource for competitive advantage of any firm (Fombrun, 1996; Capozzi, 2005). In this context, the concepts of reputation, reputation management (RM), and reputation management (RM) activities attract attention particularly from the management and marketing areas examining the question of how to be competitive (i.e., Roberts and Dowling, 1997; Hutton et al., 2001; Capozzi, 2005; Cretu and Brodie, 2007).

Reputation is ocurred around individuality, what a person or an organization is known for. In business literature, it is therefore defined as an overall evaluation of the extent to which a firm is substantially "good or bad", or "positive or negative" (Deephouse, 2000; Roberts & Dowling, 2002). The reputation occured for a firm in the marketplace can include real, perceived and incorrect dimensions. Even if it is sometimes incorrect or unreal, reputation of a firm has a power to influence consumers' reactions. There is a consensus among academicians on corporate reputation that must be purposefully managed rather than driving by chance so that it can contribute to the competitiveness of the firm ( Fombrun, 1996; Formbrun and van Riel, 2004; Simoes et al., 2005). Thus, designing specific activities to manage the process of building reputation comes into prominence from strategic behavior.

## Corporate Image

Corporate image is described as the overall impression made on the minds of individuals about an organization (Finn, 1961; Kotler, 1982; Dichter, 1985; Barich and Kotler, 1991). In marketing literature, image is defined as a mental construct processed internally (Crompton, 1979), or as a mental picture of consumers (Dobni and Zinkhan, 1990) for any given offering such as business name, variety of products, package design and quality, appearance of store.

Some empirical evidence in marketing field clearly show that long-term reputation of the seller has been found to be more important than short-term product quality movements (Landon & Smith, 1997). McKnight et al., (1998) report, based on empirical research, that corporate reputation provides assurance of consumers' integrity and goodwill. Assurance also help to increase trust, particularly when the consumers have not experience before and hence do not have first hand knowledge for the firm. A typicall example provides a valuable insight for this relation: there is a perceive notion around the world that products processed in China will not have long-life due to not meeting quality standards. Products from China maybe really unquality or low-quality and it is normally expected that consumers experienced these products before will avoid new transactions, but it is not uncommon to observe consumers avoiding made-in-China products who have not experience with them before. It is possible to explain this type of consumer behavior with poor reputation of China in marketplace. Poor reputation results in poor image in the minds of consumers.

It is, therefore, expected that the more positively consumers think about a firm, the more positively their perceptions towards the corporate image. In line with the foundation built above, the following hypothesis is proposed:

**H1:** There is a positive relationship between RM activities and corporate image.

## Trust

From the view of social exchange theory (Blau, 1964; Cook and Emerson, 1978) trust is a leading factor in a relation between consumers and the firm. The theory emphasizes the importance of human psychology in forming social exchanges. Research prove that the lack of trust can directly disrupt to get a relationship on from consumer side. Thus, trust can be described as a psychological antedecent for consumer behavior (Garbarino and Johnson, 1999; Ba and Pavlou, 2002; Pavlou and Gefen, 2004).

Serving to the creation of positive reputation for the firm through specific and pre-planned activities, and managing the corporate image can increase the value of the intangible assets such as trust (Calantone, Cavusgil & Zhao, 2002). Positive reputation of the firm and brilliant corporate image are expected to function as a preceding state for trust in consumer psychology, based on social exchange theory. Several research (Weigelt & Camerer, 1988; Garbarino & Johnson, 1999; Plank, Reid, & Pullins, 1999) report that corporate reputation has a vital role in reducing the uncertainty consumers encounter when they evaluate firms. Positive corporate reputation is based on superior performance over a certain period of time. In other words, positive corporate reputation can lead creating confidence, and thus increasing the trust (Morgan & Hunt, 1994). Based on the above reasoning we propose that:

**H2**: There is a positive relationship between RM activities and consumer trust.

**H3:** There is a positive relationship between corporate image and consumer trust.

## Perceived Risk

The factor of risk perceived by consumers has been a foremost question in marketing discipline (Murray and Schlacter, 1990; Dowling and Staeling, 1994; Mitchell, 1999) since it has been considered to be a leading part of human psychology in decision-making process. Risk is defined as an individual's or a group's perceptions of the uncertainty for engaging in an activity (Dowling and Staelin, 1994). Bauer (1960) stated this "the uncertain consequences resulting from purchase". From this perspective, risk perceptions of consumers arise from potentially negative results of any engagement. Some academicians (Engel, Blackwell, and Miniard (1986, p. 109) consider perceived risk as "beliefs about the risks associated with product (service) purchase''. In marketing literature there is a widely accepted classification based on the study of

Jacoby and Kaplan (1972) that includes financial, physical, psychological, performance, and social risk. Greatoresk and Mitchell (1994) identified social risk as “social loss”, and added the sixth category as time risk.

Trust and percived risk are closely interrelated (Mayer et al., 1995). In terms of managerial perspective, consumer trust and positive corporate image leads to more positive perceptions towards the quality of the products, and the firm as a whole. Marketing literature, based on a vast body of empirical evidence, suggests that the mentioned constructs encourage consumers by cutting negative associations about the firm (McKnight et al., 1998; Garbarino and Johnson, 1999; Pavlou and Gefen, 2004; Cretu & Brodie, 2007). In other words, the level of perceived risk can be decreased by increasing the positive clues.

The higher the perceptions of risk, the higher the trust needed to facilitate a transaction. When risk is present, higher level of trust is needed to make transactions possible. That is, consumer trust toward a product or an organization reduces the perceived risk for a specific offering. As a result, the firms attached to positive associations are expected to behave well and avoid negative behaviors, which strengthen customers' perceptions towards lower level perceived risk. Based on this view we hypothesize that:

**H4:** There is a negative relationship between corporate image and perceived risk by consumers.

**H5:** There is a negative relationship between consumer trust and perceived risk by consumers.

## Choice Behavior

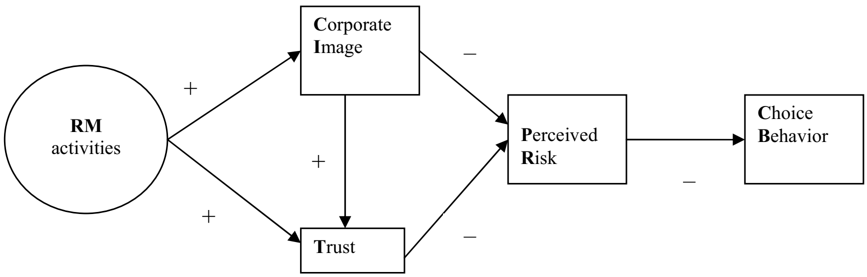
Understanding the essential determinants in the process of the evaluation of consumers behavior has been a supreme aim in the field of marketing. It is possible to state that customers’ evaluations towards a product, a brand or the name of the organization are signals of actual choice behavior (Zeithaml, Berry and Parasuraman,1996), based on structural psychology (George ve Jones, 1999, p.532) in which human behaviors are described as the activity done consciously. This description also emphasizes the important difference between “behavior” and “motion”. The underlying indication from the discipline of psychology emphasizing the connection between behavior and its antecedents explains specifically that most human behavior is under volitional control (Ryan, 1970). There are different ways of examining choice behavior of consumers in marketing literature. For example, Bloemer and Odekerken-Schröder (2007) examines price insensitivity in the context of choice behavior. Bansal, Irving, and Taylor (2004) investigate consumers’ choice behaviors in the context of switching intentions. On the other hand, Mittal, Kumar, and Tsiros (1999) measure customers' intention to recommend to other people, which can be considered to be an indicator of choice behavior if it is positive.

Consumers’ choice behaviors among competing offerings emerge based on maximazing their benefits as it is implied in the explanations from psychology area (Becker, 1990; Tversky and Kahneman, 1981). Lower level of risk perceived by consumers is a direct part of higher benefits. In other words, reducing risk ensures consumers to reach more satisfactory results. A rational theory of consumer behavior (Tversky and Kahneman, 1986, 1991) imply that consumers will employ the level of risk they perceive as a cue for their possible satisfaction. From this perspective, perceived risk by consumers is a main indicator in terms of whether they engage in a brand or a firm. In short, the more risk consumers perceive the less choice behavior they exhibit. More specifically, if they perceive relatively higher level of risk towards a firm, then they are more likely to have the intension not to prefer, switching intensions, negative word-of-mouth and price sensitivity. Based on this view we hypothesize that:

**H6:** There is a negative relationship between perceived risk and choice behavior of consumers.

Building on the literature review and the hypotheses developed, the following model emerged as the research model of this study (figure 1). In the research model, five main constructs and the relations between them are examined through hypothesized paths.

**Fig. 1.** Conceptual model and hypothesized relations




# RESEARCH DESIGN

The research in this study was conducted by employing a quantitative methodology. In this context, a structured questionnaire was developed as data collection instrument based on literature review and previous research (e.g., Sirdeshmukh et al., 2002; Selnes and Sallis, 2003; Dowling, 2006). The sample for this survey consisted of customers who were staying at Sheraton Hotels in Tirana, Albania and Istanbul, Turkey, in the period of February – April 2009. The survey was limited to only businessmen segment due to their constant demand for hotel services, and thus their enhanced familiarity. The design of the questionnaire was based on 5 different constructs examined in this research. As presented in table 1, 2, 3, 4 and 5, reputation management (RM) activities were measured using the scale adopted from Fombrun (1998) and Fombrun, Gardberg, and Sever (2000). Items for measuring consumer trust were adopted from Selnes and Sallis (2003). The construct of corporate image was adopted from the study of Wu and Petroshius (1987). For the variable of perceived risk, we employed the well-known definition of Engel, Blackwell, and Miniard (1986, p. 109) and well-established classification of Jacoby and Kaplan (1972) for perceived risk by consumers. And finally, choice behavior was measured using items from Bansal et al., 2004; Mittal et al., 1999; Zeithaml et al., 1996).

All constructs were measured on five-point Likert scales ranging from Definitely agree to Definitely disagree. The overall value of the Cronbach alpha to assess the reliability of the variables was 0.83, indicating a satisfactory level.

## Descriptive Statistics

In total, 268 usable questionnaires were collected from participants over the course of three months (February – April 2009) in Albania and Turkey simultaneously. Of those gathered thirty-six forms were eliminated (13.4 %) due to excessive amount of missing data. Thus, 232 forms of data were coded for data analysis. The distribution of questionnaires analysed by country is as follows: Respondents from Albania were 109 (47 %) and from Turkey were 123 (53 %) of the overall sample. The analysis of demographic characteristics of the sample revealed that most of them were male (169 respondents; 73 %) and in the 45 – 60 year age category (171 respondents; 73.7 %). Just above half had a university degree (131 respondents; 56.4 %).

# DATA ANALYSIS AND RESULTS

## Analysis of Differences between Albanian and Turkish Consumers

In the first step of the analysis, the collected data were analyzed by employing the SPSS program. A series of independent t- tests were used to determine if differences existed between Albanian and Turkish consumers across the constructs of the research model. Table 1 indicates the differences between the subgroups of the sample in the evaluation of RM activities.

**Table 1:** Mean Differences between Albanian and Turkish Consumers for RM Activities

| statements | AL | TR | t – value | Sig. |
|---|---|---|---|---|
| Average | **4.46** | **4.80** | **-1.83** | 0.068 |
| Declaring to provide high quality offerings every time | 4.22 | 4.61 | -1.81 | 0.071 |
| Declaring to provide value-for-money offerings every time | 4.32 | 4.55 | -1.36 | 0.173 |
| Declaring to provide new and innovative offerings every time | 3.96 | 4.67 | -2.61 | **0.015** |
| Declaring that the philosophy shared by all staff is high customer satisfaction | 4.43 | 4.38 | 1.81 | 0.071 |
| Showing its upper-class level through comments on media | 4.51 | 4.77 | -1.62 | 0.103 |
| Announcing the names of famous guests staying at Sheraton | 4.46 | 4.71 | -2.47 | **0.022** |
| Employing upper-class marketing channells | 4.49 | 4.40 | 0.56 | .510 |
| Creating a feeling of first-class company through specific advertisements | 4.24 | 4.65 | -2.59 | **0.011** |
| Designing an extraordinary building in external view | 4.79 | 4.61 | 0.810 | 0.412 |
| Designing exclusive atmosphere inside the hotel | 4.88 | 4.29 | 3.26 | **0.003** |
| Providing excellent working environment to its staff | 4.63 | 4.51 | 1.87 | 0.062 |
| Equiping its staff with superior qualifications | 4.70 | 4.27 | 2.27 | **0.025** |
| Building high standards in human relations | 4.83 | 4.52 | 1.75 | 0.078 |
| Hosting and sponsoring eminent art events | 4.80 | 4.66 | 1.82 | 0.070 |
| Hosting many popular meetings (official meetings, popular weddings, cocktail parties) | 4.21 | 4.79 | -2.51 | **0.014** |
| Supporting and announcing many societal projects | 3.91 | 4.48 | -2.38 | **0.017** |
| Declaring its environmental responsibility and sensitivity | 4.27 | 4.49 | -1.77 | 0.075 |

**Note:** The negative t-values mean that Turkish respondents have higher mean scores than Albanian respondents for the related items. The criteria were based on a five-point scale, ranging from "1= Definitely agree" to "5= definitely disagree".

The findings of the comparison between Albanian and Turkish groups showed that Turkish consumers had a slightly higher. But this finding cannot be confirmed by statistical results ($p>0.05$). Based on the results in table A, no significant difference was found for the evaluation of RM activities. Although Turkish consumers have higher scores, Albanian consumers also have very positive overall evaluations towards the firm's RM activities. It should be noted that the largest difference was found in the "designing exclusive atmosphere inside the hotel" ($p < 0.01$), indicating one of the lowest scores from Turkish group as

4.29 that means very positive. This means that both groups in different countries have similarly positive perceptions for RM activities of the firm.

While analyzing the relationships among the constructs across the research model, the second construct is determined as *corporate image*. Table 2 reports the view of the corporate image from the respondents' evaluations**.**

**Table 2:** Mean Differences between Albanian and Turkish Consumers for Corporate Image

| The firm | **AL** | **TR** | **t -value** | **Sig.** |
|---|---|---|---|---|
| **average** | **4.61** | **4.41** | **1.74** | 0.078 |
| Has a pleasant atmosphere | 4.62 | 4.48 | 1.80 | 0.073 |
| a well-known brand | 4.90 | 4.77 | 1.66 | 0.104 |
| Has high quality goods and services | 4.82 | 4.33 | 2.21 | **0.028** |
| Well-managed firm | 4.41 | 4.44 | -0.67 | 0.498 |
| Has polite staff | 4.33 | 4.68 | -1.72 | 0.081 |
| Has consumer-oriented staff | 4.22 | 4.31 | -0.86 | 0.397 |
| Attracts upper-class customers | 4.76 | 4.28 | 2.10 | **0.036** |
| Means prestigious | 4.60 | 4.12 | 1.99 | **0.039** |
| Exclusive firm | 4.88 | 4.36 | 2.14 | **0.033** |

**Note:** The negative t-values mean that Turkish respondents have higher mean scores than Albanian respondents for the related items. The criteria were based on a five-point scale, ranging from "1= Definitely agree" to "5= definitely disagree".

Table 2 shows that there is no significant difference between Albanian and Turkish consumers for the evaluations towards CI of the firm. Both groups are seen to have very positive assessments. In comparison with those of Albanian consumers, Turkish consumers had slightly lower scores but not confirmed statistically ($p > 0.05$). Similarly, in both groups the most positive evaluation was reported on the item *the firm is a well-known brand* (mean scores: 4.90 and 4.77, respectively). For Albanian group, clearly it is possible to see the reflections of CI since they ranked the item *it is an exclusive firm* as second highest (4.88). Also in Turkish group, it should be noted that overall scores for CI items are above 4.00. The largest difference existed between the groups on *the firm has high quality goods and services* which means that the former had much more positive views than the latter ($p < 0.05$). However, the mean value of Turkish group for this item can also be considered rather positive (4.33). The data obtained from the sample of this study in two different countries clearly prove a brilliant CI for the firm in the minds of respondents.

**Table 3:** Mean Differences between Albanian and Turkish Consumers for Trust*

| | AL | TR | t -value | Sig. |
|---|---|---|---|---|
| **average** | **4.59** | **4.42** | **1.73** | 0.081 |
| I trust that S is competent at what they are doing | 4.89 | 4.41 | 1.81 | 0.070 |
| I feel that S is trustworthy. | 4.81 | 4.13 | 3.31 | **0.001** |
| I feel that S is honest to fulfill its promises | 4.70 | 4.19 | 2.12 | **0.034** |
| I think that S is very responsive to customers. | 4.33 | 4.68 | -1.77 | 0.076 |
| I believe that S will respond with understanding in the event of problems | 4.22 | 4.72 | -1.87 | 0.064 |

**Table 4:** Mean Differences between Albanian and Turkish Consumers for Perceived Risk*

| | AL | TR | t – value | Sig. |
|---|---|---|---|---|
| **average** | **4.40** | **4.65** | **- 1.82** | 0.068 |
| In S, Facing offerings that are not value-for-money is a serious risk. (R) | 4.32 | 4.60 | - 1.91 | 0.063 |
| Satisfactoriness of physical environment in S is a serious risk. (R) | 4.45 | 4.62 | - 1.94 | 0.062 |
| It is a serious risk that the goods and services offered by S can be inadequate in order to meet my needs (R) | 4.12 | 4.71 | - 2.31 | **0.024** |
| Staying at S can create unhappiness in my inner world (R) | 4.76 | 4.81 | - 1.35 | 0.177 |
| If I say to friends that I prefer S, they may condemn me (R) | 4.38 | 4.53 | - 1.79 | 0.071 |

**Table 5:** Mean Differences between Albanian and Turkish Consumers for Choice Behavior*

| | AL | TR | t-value | Sig. |
|---|---|---|---|---|
| **average** | **4.25** | **4.12** | **1.57** | |
| I will prefer S in the future. | 4.13 | 4.05 | 1.80 | 0.073 |
| I will consider S the first choice at which to stay. | 4.58 | 4.37 | 1.93 | 0.058 |
| I don't think that the other brands will provide clearly better offerings. | 4.11 | 4.07 | 1.86 | 0.062 |
| It is a low possibility that I will shift S with a competitive one. | 4.18 | 3.99 | 1.74 | 0.081 |

* **Note:** The negative t-values mean that Turkish respondents have higher mean scores than Albanian respondents for the related items. The criteria were based on a five-point scale, ranging from "1= Definitely agree" to "5= definitely disagree".
R: Reverse coded.

The findings of the comparison between Albanian and Turkish consumers for the dimension of *trust* are presented in Table 3. Based on average scores come from the subgroups of the sample, a statistically significant difference was not reported by significance level ($p > 0.05$) for t-value computed (1.73). Respondents both in Albania and Turkey seem similar to each other in terms of trust towards Sheraton (grand mean values: 4.59 and 4.42, respectively). The largest difference between the groups was observed for item *I feel that Sheraton is trustworthy* which means Albanian respondents clearly much more positive attitudes in favor of Sheraton than the respondents in Turkey (mean values: 4.81 and 4.13, respectively). Based on the grand mean values, it is possible to state that the sample as a whole clearly has the feeling of trust towards the firm.

Table 4 provides the results of *perceived risk* by respondents towards the firm, Sheraton. The results reveal that there were no significant differences between the mean scores except one item on *risk for inadequacy of offerings to meet individual needs* (($p < 0.05$). It is important to note that this part of the scale measuring *perceived risk* towards the firm was established with 5 reverse coded items. The negative signs of the t-values indicate less perceived risk by Turkish respondents than Albanians. However, the mean scores of Albanians can be considered as a strong indicator that they perceive risk at minimum level towards the firm. Likewise the grand mean scores for both 2 groups report the similarity statistically (t-value: - 1.82 and $p > 0.05$). This result shows that the respondents both in Albania and Turkey are sure about the standards of the firm, and thus they do not worry about the firm and its offerings.

Table 5 summarizes the data obtained from the sample on their *choice behavior*. According to the results shown in table 5, overall the items were assessed similarly by Albanian and Turkish respondents. These four items all have a probability value that is more than .05. Grand mean scores for both groups (4.25 and 4.12, respectively) did not produce statistically significant difference (t-value: 1.57 and $p > 0.05$). The mean scores ranged from 4.11 to 4.58 in the group of Albanians, and from 3.99 to 4.37 in Turkish group, indicating a strong loyalty or very positive choice intention in the future. These findings indicate that respondents preferred the firm, Sheraton, consciously at present, and clearly they have a tendency to keep this behavior on.

The overall analyses of responses through 5 t-test operations point out the obvious resemblance between Albanian and Turkish respondents towards the given stimuli. It should be noted that those stimuli are the main constructs within the research model of this study. It is possible, therefore, to put together the subgroups of the sample while analyzing the research model rather than conducting separate analyses.

## Analysis of the Research Model

This study was designed to understand the effects of the factor of reputation management which target market considers when they prefer a brand or a firm rather than its competitors. In this study, a structured model related to the variables assumed to be influential on choice behavior of consumers was tested by employing the Structural Equation Modeling (SEM). The structure, composed of the relationship of 4 assumed constructs to one main dependent variable (choice behavior) constitutes the model of the study to be tested. As mentioned before, the reliability coefficient of the overall scale was computed as Cronbach alpha ; 0.83. Data analysis involves evaluation of the measurement model and the structural model.

## The Evaluation of the Overall Model

For the overall model, the Chi-square value was found significant as 514.93 with 233 degrees of freedom. This value is not unusual for larger sizes of sample (Doney and Cannon, 1997). The ratio of Chi-square to degree of freedom is 2.21, which is adequate statistically for the fit of the model. Although the values of GFI (0.93) and AGFI (0.92) are lower than those of CFI (0.97), NFI (0.93) and NNFI (0.94), it is accepted that CFI values above 0.95 are suggestive of a meaningful model (Hu and Bentler, 1999). The fit indices calculated here with RMSEA (0.058) and SRMSR (0.073) can be considered as adequate. All related indices were summarized in Table 6.

**Table 6:** Goodness-of-fit summary

| **Fit indices** | **Values** |
|---|---|
| $X^2$ | 514.93 |
| Ratio ( $X^2$/ df ) | 2.21 |
| GFI | .93 |
| AGFI | .92 |
| NFI | .93 |
| NNFI | .94 |
| CFI | .97 |
| Standardized RMSR | .07 |
| RMSEA | .06 |

GFI, Goodness of fit index; AGFI, Adjusted Goodness of fit index; NFI, Bentler-Bonett normed fit index; NNFI, Bentler-Bonett non-normed fit index; CFI, comparative fit index; RMSR, root mean squared residual, RMSEA, root mean squarred error of approximation.

## Measurement Model

The quality of the model was assessed on unidimensionality, convergent validity, reliability and discriminant validity (*see* Table 7). The unidimensionality of each construct in the model was analyzed with principal component analysis that reveals the appropriate items loaded at least 0.60 on the hypothesized components. A good overall model fit has provided support for convergent validity of the scale through all loadings that were significant ($p < 0.05$). Many of the $R^2$ values have exceeded 0.50 proposed by Fornell and Larcker (1981). On the other hand, reliability of the measurement model was analyzed based on the values of composite reliability that should be greater than the benchmark of 0.70 to be considered adequate (Fornell and Larcker, 1981). As indicated in table 7, all the reliability values are above 0.70, revealing adequate reliability.

Discriminant validity was tested by confirmatory factor model in which correlations between constructs were constrained to 1, Chi-square differences were significant throughout the model ($p < 0.01$). The model of the study, therefore, is proper to be applied for understanding the relationships between the constructs given with the support of reliability, convergent validity, discriminant validity and unidimensionality.

**Table 7:** Measurement Model

| | | Composite reliability | Variance Explained | Loading | $R^2$ |
|---|---|---|---|---|---|
| **Reputation Management Activities** | 1. Declaring to provide high quality offerings every time | **0.77** | **0.72** | 0.88 | 0.74 |
| ( Fombrun, 1998; | 2. Declaring to provide value-for-money offerings every time | | | 0.81 | 0.63 |
| Fombrun, Gardberg, and Sever ,2000 ) | 3. Declaring to provide new and innovative offerings every time | | | 0.76 | 0.55 |
| | 4. Declaring that the philosophy shared by all staff is high customer satisfaction | | | 0.89 | 0.74 |
| | 5. Showing its upper-class level through comments on media | | | 0.72 | 0.52 |
| | 6. Announcing the names of famous guests staying at S | | | 0.67 | 0.48 |
| | 7. Employing upper-class marketing channels | | | 0.63 | 0.42 |
| | 8. Creating a feeling of first-class company through specific advertisements | | | 0.92 | 0.79 |
| | 9. Designing an extraordinary building in external view | | | 0.76 | 0.55 |
| | 10. Designing exclusive atmosphere inside the hotel | | | 0.91 | 0.79 |
| | 11. Providing excellent working environment to its staff | | | 0.81 | 0.63 |
| | 12. Equipping its staff with superior qualifications | | | 0.78 | 0.58 |
| | 13. Building high standards in human relations | | | 0.66 | 0.46 |
| | 14. Hosting and sponsoring eminent art events | | | 0.62 | 0.42 |
| | 15. Hosting many popular meetings (official meetings, popular weddings, cocktail parties) | | | 0.72 | 0.52 |
| | 16. Supporting and announcing many societal projects | | | 0.63 | 0.42 |
| | 17. Declaring its environmental responsibility and sensitivity | | | 0.72 | 0.52 |

| | | | | | |
|---|---|---|---|---|---|
| **Corporate Image** ( Wu and Petroshius 1987) | 1. Has a pleasant atmosphere | **0.83** | **0.62** | 0.81 | 0.63 |
| | 2. Well-known brand | | | 0.70 | 0.51 |
| | 3. Has high quality goods and services | | | 0.84 | 0.68 |
| | 4. Well-managed fim | | | 0.73 | 0.52 |
| | 5. Has polite staff | | | 0.93 | 0.83 |
| | 6. Has consumer-oriented staff | | | 0.89 | 0.74 |
| | 7. Attracts upper-class customers | | | 0.82 | 0.63 |
| | 8. Means prestigious | | | 0.90 | 0.79 |
| | 9. Exclusive firm | | | 0.77 | 0.56 |
| **Trust** ( Selnes and Sallis, 2003). | 1. I trust that S is competent at what they are doing | **0.78** | **0.66** | 0.73 | 0.52 |
| | 2. I feel that S is trustworthy. | | | 0.91 | 0.79 |
| | 3. I feel that S is honest to fulfill its promises. | | | 0.82 | 0.63 |
| | 4. I think that S is very responsive to customers. | | | 0.71 | 0.52 |
| | 5. I believe that S will respond with understanding in the event of problems. | | | 0.75 | 0.55 |
| **Perceived Risk** | 1. In S, Facing offerings that are not value-for-money is a serious risk (R) | **0.85** | **0.72** | 0.70 | 0.51 |
| ( Engel, Blackwell, | 2. Satisfactoriness of physical environment in S is a serious risk (R). | | | 0.89 | 0.74 |
| and Miniard,1986 ; | 3. It is a serious risk that the goods and services offered by S can be inadequate in order to meet my needs. (R) | | | 0.83 | 0.64 |
| Jacoby and Kaplan,1972) | 4. Staying at S can create unhappiness in my inner world. (R) | | | 0.69 | 0.51 |
| | 5. If I say to friends that I prefer S, they may condemn me. (R) | | | 0.92 | 0.79 |
| **Choice Behavior** ( Bansal et al., 2004; | 1. I will prefer S in the future. | **0.88** | **0.74** | 0.83 | 0.64 |
| Mittal et al., 1999; | 2. I will consider S the first choice at which to stay. | | | 0.84 | 0.66 |
| Zeithaml et al., 1996 ) | 3. I don't think that the other brands will provide clearly better offerings. | | | 0.94 | 0.83 |
| | 4. It is a low possibility that I will shift S with a competitive one. | | | 0.88 | 0.74 |

## Structural Model

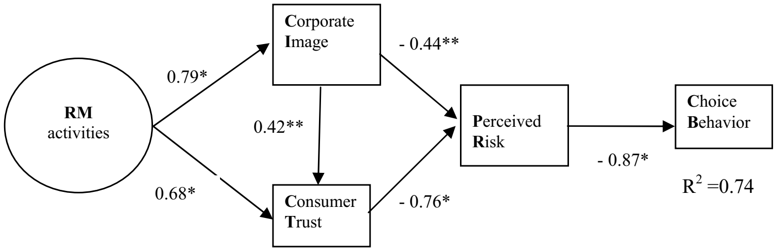
The estimates and hypothesis results are summarized in Table 8. Furthermore, figure 2 also provides the complete model with the path estimates. The model explained 62 – 74 % of the variance ($R^2$ scores). Overall, the research model accounted for 74 % of the variance of choice behavior.

**Table 8:** Structural Model of RM Activities on CI, CT, PR and CB

| Parameter (Paths) → | | Hypothesis | Estimates |
|---|---|---|---|
| RM Activities | Corporate Image | H1 (+) | 0.793* |
| RM Activities | Consumer Trust | H2 (+) | 0.678* |
| Corporate Image | Consumer Trust | H3 (+) | 0.423** |
| Corporate Image | Perceived Risk | H4 (–) | - 0.447** |
| Consumer Trust | Perceived Risk | H5 (–) | - 0.763* |
| Perceived Risk | Choice Behavior | H6 (–) | - 0.872* |
| Squared Multiple Correlations for Structural Equations | | Estimates | |
| Corporate Image | | 0.71 | |
| Consumer Trust | | 0.62 | |
| Perceived Risk | | 0.66 | |
| Choice Behavior | | 0.74 | |

* $p < 0.001$
** $p < 0.01$

**Figure 2:** SEM Analysis of the Research Model




* $p < 0.001$ , ** $p < 0.01$

As seen in table 8, all proposed relationships between the constructs of the model were supported by the statistical results. The standardized estimates of the structural parameters (i.e., RM activities ► corporate image and consumer trust, and corporate image ► consumer trust) prove that consumers' evaluations toward RM activities positively influence the view of corporate image in their minds (see table 8, r: .79 and $p < 0.001$).

Similarly, RM activities to be exposed clearly determine consumer trust positively towards the firm who organized RM activities (r: .68 and $p < 0.001$). These outcomes confirm H1, in that positive evaluations of consumers towards RM activities of the firm lead to positive corporate image in their minds. Also, the hypothesis H2 was confirmed by the results, in that positive evaluations of consumers towards RM activities lead to higher level of trust towards the firm in consumer psychology. It is possible, therefore, to state that RM activities organized by firms have a direct influence on both the appearance of the firm in the marketplace, and inner evaluation processes consumers activate. Thus, RM activities of firms have a power to create doubled effect on consumers' decision making process as external and internal stimuli.

Consumer trust is also positively influenced by corporate image, as hypothesized in H3 (r: .42 and $p < 0.01$). This confirmation for H3 shows that positive corporate image in the minds of consumers plays a supportive role to enhance the feeling of trust in consumer psychology. Therefore, RM activities have both direct influences on consumer trust, and indirect influences on it through corporate image.

H4 and H5 investigate the impact of corporate image and consumer trust on the factor of perceived risk. The standardized estimates of the structural parameters reveal that corporate image has a significant effect on perceived risk, but in negative direction (r: - .44 and $p < 0.01$). In other words, perceived risk by consumers for a given firm is negatively influenced by corporate image in the mind of consumers. That is, the more positive corporate image consumers assume the less perceived risk they have. Also, the results confirm H5, in that a higher consumer trust toward a firm leads to a lower perceived risk by consumers (r: - .76 and $p < 0.001$). Thus, perceived risk by consumers is influenced significantly by the two variables in negative direction, as hypothesized in the research model. Comparing the values of the two coefficients, it appears that consumer trust has greater influence on perceived risk by consumers than corporate image they have.

The analyses of the hypotheses obviously point out that perceived risk by consumers is a significant determinant on their choice behavior (r: - .87, $p < 0.001$), in support of H6. Perceived risk seems to have a negative impact on choice behavior of consumers, just as hypothesized at the beginning of the research. Based on this test result, one can infer that higher perceived risk will result in lower choice behavior. Thus, it is possible to say that in order to increase the positive attitude toward choice of firm's offerings, perceived risk should be cut off through enhancing consumer trust based on RM activities.

Overall, all the parameters are significant in the research model. According to Chin (1998), in order coefficients to be considered meaningful they should be above the value 0.2. In our research model all parameters were computed between 0.42 – 0.87, indicating considerable impact. Moreover, all the structural relationships are in the hypothesized direction (table 8). These findings strongly support the positive relationships between RM activities and corporate image created in the minds of consumers and consumer trust in psychological structure (figure 2), negative relationships between corporate image - consumer trust and perceived risk, and then a negative relationship between perceived risk and choice behavior. These results are not only consistent with the findings of previous studies (e.g. Benjamin and Podolny, 1999; Keh and Xie, 2008) but also with our expectations of associated relationships among the constructs.

# CONCLUSION

This paper aims to understand the role of RM activities on consumers' choice behaviors. Drawing on the literature for reputation management and behavioral intensions of consumers, this research study theoretically develops and empirically measures a model analyzing the effects of RM activities toward the evaluations of consumers and then choice behavior. In conclusion, choice behavior of consumers can be predicated as a dependent variable with a rate of 74 % through antecedent constructs triggered by RM activities.

Empirical results clearly reveal that perceived risk by consumers plays a determinative role in the process. Therefore, we should especially focus on how to minimize perceived risk through RM activities. It is possible to say that RM activities influence consumers' decision making process with indirect effects by enhancing corporate image and creating trust. The empirical results of this study show that perceived risk can be decreased by increasing consumer trust and positive corporate image based on RM activities of firms. Thus, if firms organize specific RM activities (i.e. making *high-volume and continuous* commitments to the market for superior customer satisfaction, announcing the famous people preferring the offerings of the firm, sponsoring important events in social life) strategically and systematically, this will able to function in building positive judgements resulting in lesser perceived risk and finally in more positive tendencies to prefer any given firm's offerings.

We note that the findings of this study should be assessed together with some specific limitations. First, the data required were collected from actual customers of a firm within its business atmosphere rather than in an unrelated place. However, designing a research activity in Sheraton was the result of the difficulties to reach consumers for examining the reflections of RM activities of any firm.

Second, although all hypotheses are supported, the findings of this study were generated from the customers of only one firm. This type of research should be reinforced by a variety of research outputs examining the other firms' cases.

Finally, the research model developed in this study can be expanded by other possible antecedents and consequences of reputation management (i.e., corporate identity, consumer sensitivity) to be able to produce more sophisticated understanding.

# REFERENCES


Ajzen, I., and Fishbein, M. (1980), *Understanding Attitudes and Predicting Social Behavior*, Prentice-Hall, Englewood Cliffs, NJ,

Anderson, E., and Weitz, B. A. (1989), Determinants of continuity in conventional industrial channel dyads, *Marketing Science*, 8 (4), 310–323

Ba, S. and Pavlou, P.A. (2002), Evidence of the effect of trust building technology in electronic market: price premiums and buyer behavior, *MIS Quarterly*, 26 (3), 243 – 268

Balmer, J.M.T. and Gray, E.R. (1999), Corporate identity and corporate communication: creating a strategic advantage, *Corporate Communications: An International Journal,* 4 (4),171-6.

Bansal, H. S., Irving, G. P., and Taylor, S. F. (2004), A three-component model of customer commitment to service providers, *Journal of the Academy of Marketing Science*, 32 (3), 234−250

Barich, H. and Kotler, P. (1991), A framework for marketing image management, *Sloan Management Review*, 32(2), 94-104

***Bauer, R.A, (1960),* Consumer behavior as risk taking. Dynamic marketing for a changing world, *American Marketing Association, Chicago, IL***

Barney, J. (1991), Firm Resources and Sustained Competitive Advantage, *Journal of Management*, 17 (1), 99-120.

Becker, G.S. (1990), *The Economic Approach to Human Behavior*, The University of Chicago Press

Benjamin, B.A. and Podolny, J.M. (1999), Status, quality and social order in California wine industry. Administrative Science Quarterly, 44 (3), 563 – 589

Blau, P. M. (1964), *Exchange and Power in Social Life,* John Wiley and Sons, New York, NY

Bloemer, J. and Odekerken-Schröder, G. (2007), The Psychological Antecedents of enduring customer relationships: an empirical study in a bank setting, *Journal of Relationship Marketing*, 6 (1), 21 – 43

Brown, T. J., Dacin, P. A., Pratt, M. G., and Whetten, D. A. (2006), Identity, intended image, construed image, and reputation: an interdisciplinary framework and suggested terminology, *Journal of the Academy of Marketing Science*, 34(2), 99−106

Calantone, R.J., Cavusgil, S.T. and Zhao, Y. (2002), Learning orientation, firm innovation capability, and firm performance, *Industrial Marketing Management*, 31(6), 515- 524

Capozzi, L. (2005), Corporate reputation: our role in sustaining and building a valuable asset. Journal of Advertising Research, 45 (3), 290 – 293

Carmeli, A. and Tishler, A. (2005), Perceived organizational reputation and organizational performance: an empirical investigation of industrial enterprises, *Corporate Reputation Review*, 8(1), 13−30.

Chen, L. and Tan, J. (2004), Technology Adaptation in E-commerce: Key Determinants of Virtual Stores Acceptance, *European Management Journal*, 22 (1), 74-86.

Chin, W. W. (1998), Issues and Opinion on Structural Equation Modeling. *Management Information Systems Quarterly*, 22 (1), vii – xvi.

Cook, K.S. and Emerson, R.M. (1978), Power, equity and commitment in exchange Networks, *American Sociological Review*, 43 (5), 721 – 739

Cretu, A. E., and Brodie, R. J. (2007), The influence of brand image and company reputation where manufacturers market to small firms: a customer value perspective, *Industrial Marketing Management*, 36(2), 230−240.

Crompton, J.L. (1979), An Assessment of the Image of Mexico as a Vacation Destination and the Influence of Geographical Location Upon That Image, *Journal of Travel Research,* 17(4), 18-24

Davies, G., Chun, R., da Silva, R. V. and Roper, S. (2003), *Corporate Reputation and Competitiveness*, Routledge, Londra, New York

Davies, G., Chun, R., da Silva, R. and Roper, S. (2002), Corporate reputation and performance in Germany, *Corporate Reputation Review*, 2, 115-123

Deephouse, D.L. (2000), Media reputation as a strategic resource: an integration of mass communication and resource-based theories, *Journal of Management*, 26 (6), 1091 – 1112

Dichter, E., (1985), What's in an image?, *Journal of Consumer Marketing* 2(1), 75–81

Dobni, D. and Zinkhan, G.M. (1990), In Search of Brand Image: A Foundation Analysis. *In* Advances in Consumer Research, M. E. Goldberg, G. Gorn and R. W. Pollay, eds, Vol. 17: Provo, UT: Association for Consumer Research, 110−119

Doney, P. M. and Cannon, J. P. (1997), An examination of the nature of trust in buyer–seller Relationships, *Journal of Marketing*, 61(2), 35−51

Dowling, G.R. and Staelin, R. (1994), A Model of Perceived Risk and Intended Risk-Handling Activity, *The Journal of Consumer Research*, 21 (1), 119-134

Dowling, G. (2006), How good corporate reputations create corporate value. Corporate Reputation Review, 9 (2), 134 – 143

Engel, J.F., Blackwell, R.D. and Miniard,P.W. (1986), *Consumer Behavior*, Fifth Edition. Chicago: Dryden

Finn, D. (1961), The price of corporate vanity, *Harvard Business Review,* 39,135–143

Fombrun, C. and Shanley, M. (1990), What's in a name? Reputation building and corporate Strategy, *Academy of Management Journal*, 33(2), 233−258

Fombrun, C. J. (1996), *Reputation: realizing value from the corporate image*, Boston: Harvard Business School Press.

Fombrun, C. J. (1998), Indices of corporate reputation: an analysis of media rankings and social monitors' ranking. *Corporate Reputation Review*, 1 (4), 327 – 340

Fombrun, C. J., Gardberg, N.A., and Sever, J. M. (2000), The reputation quotient: a multi-stakeholder measure of corporate reputation. *The Journal of Brand Management*, 7 (4), 241 – 255

Fombrun, C.J. and van Riel,C. (2004), *Fame & Fortune*, FT Prentice Hall, New York.

Fornell, C. and Larcker, D.F. (1981), Evaluating Structural Equation Models with Unobservable Variables and Measurement Error. *Journal of Marketing Research*, 18, 39 – 50.

Ganesan, S. (1994), Determinants of long-term orientation in buyer–seller relationships, *Journal of Marketing*, 58, 1−19

Garbarino, E. and Johnson, M. S. (1999), The different roles of satisfaction, trust, and commitment in customer relationships, *Journal of Marketing*, 63(2), 70−87

George, J. ve Jones, G. M. (1999), *Organizational Behavior*, 2nd ed., Longman, USA

Greatorex, Mike and Vincent Wayne Mitchell. (1994), Modeling Consumer Risk Reduction Preferences From Perceived Loss Data. *Journal of Economic Psychology*, 15, 669-685.

Groenland, E.A.G. (2002), Qualitative research to validate the RQ-dimesions, *Corporate Reputation Review*, 4, 309 – 315

Hutton, J.G., Goodman, M.B., Alexander, J.B., and Genest, C.M. (2001), *Reputation management: the new face of corporate public relations*, Public Relations Review, 27, 247–261

Jacoby, J. and Kaplan, L. B. (1972), The Components of Perceived Risk, M. Venkatesan (Ed.), *Proceedings of the Third Annual Conference*. Iowa City, Iowa: Association for Consumer Research, 382-393.

Keh, H. T. and Xie, Y. (2008), Corporate reputation and customer behavioral intensions: the roles of trust, identification and commitment. Industrial Marketing Management, doi: 10.1016/j.indmarman.2008.02.005

Kotler, P. (1982), *Marketing for Nonprofit Organization*, (2nd Edition ed.), Prentice-Hall, Englewood Cliffs, NJ.

Landon, S. and Smith, C. E. (1997), The Use of Quality and Reputation Indicators by Consumers: The Case of Bordeaux Wine, *Journal of Consumer Policy*, 20: 289–323

Mayer, R. C., Davis, J. H., and Schoorman, D. F. (1995), An integrative model of organizational trust, *Academy of Management Review*, 20(30), 709−734

McKnight, D. H., Cummings, L. L., and Chervany, N. L. (1998), Initial trust formation in new organizational relationships, *Academy of Management Review*, 23 (3), 473–490

Mitchell, V-W. (1999), Consumer perceived risk: conceptualisations and models. *European Journal of Marketing*, 33 (1/2), 163 - 195

Mittal, V., Kumar, P., and Tsiros, M. (1999), Attribute-level performance, satisfaction, and behavioral intentions over time, *Journal of Marketing*, 63(2), 88−101.

***Moorman, C., Deshpandé, R. and Zaltman, G. (1993), Factors affecting trust in market research relationships,* The Journal of Marketing*, 57(1), 81-101.***

Morgan, R. M., & Hunt, S. D. (1994), The commitment–trust theory of relationship marketing, *Journal of Marketing*, 58, 20−38

*Murray, K.B. and Schlacter, J.L. (1990), The impact of services versus goods on consumers' assessment of perceived risk and variability.* Journal of the Academy of Marketing Science, *18 (1), 51 - 65*

Pavlou, P. A. and Gefen, D. (2004), Building effective online marketplaces with institution based trust, *Information Systems Research*, 15 (1), 37–59

Plank, R.E., Reid,D.A. and Pullins, E.B. (1999), Perceived trust in Business to Business sales: A new measure, *Journal of Personal Selling and Sales Management*, 19 (3), 61-71.

Podolny, J. M. (1993), A status-based model of market competition, *American Journal of Sociology*, 98(4), 829−871

Roberts, P. W. and Dowling, G. R. (2002), Corporate reputation and sustained superior financial performance, *Strategic Management Journal*, 23(12), 1077−1093

Roberts, P. W. and Dowling, G. R. (1997), The value of a firm's corporate reputation: how reputation helps attain and sustain superior profitability, *Corporate Reputation Review*, 1(1), 72−76

Ryan, T.A. (1970), *Intentional Behavior*, New York: Ronald Press.

Selnes, F. and Sallis, J. (2003), Promoting relationship learning. *Journal of Marketing*, 67 (3), 80 – 95

Simoes, C., Dibb, S. and Fisk, R.P. (2005), Managing corporate identity: an internal perspective, *Journal of the Academy of Marketing Science,* 33 (2), 153 – 168

Sirdeshmukh, D., Singh, J. and Sabol, B. (2002), Consumer trust, value, and loyalty in relational exchanges. *Journal of Marketing*, 66 (1), 15 – 37

Sultan, F. and Mooraj, H.A. (2001), Designing a trust-based E-business strategy, *Market Management*, 10(4), 40–45.

Taewon, S. and Amine, L.S. (2007), Defining and Managing Reputational Capital in Global Markets, *The Journal of Marketing Theory and Practice*, 15 (3), 205-217.

*Tversky A. and Kahneman, D. (1981), The framing of decisions and the psychology of choice,* Science*, 211 (4481), 453-458*

*Tversky A. and Kahneman, D. (1986), Rational Choice and the Framing of Decisions,* Journal of Business*, 59 (4), 251 – 278*

*Tversky A. and Kahneman, D. (1991), Loss aversion in riskless choice: a reference – dependent model,* The Quarterly Journal of Economics*, 106 (4), 1039 – 1061*

Weigelt, K. and Camerer, C. (1988), Reputation and corporate strategy: a review of recent theory and applications, *Strategic Management Journal*, 9(5), 443−454

Weiss, A. M., Anderson, E. and MacInnis, D. J. (1999), Reputation management as a motivation for sales structure decisions, *Journal of Marketing*, 63(4), 74−89

Wu, B.T. and Petroshius, S.M. (1987), The halo effect in store image management. *Journal of the Academy of Marketing Science*, 15 (3), 44-51.

Zeithaml, V. A., Berry, L. L. and Parasuraman, A. (1996), The behavioral consequences of service quality, *Journal of Marketing,* 60(2), 31−46

# THE IMPACT OF GREEN SUPPLY CHAIN MANAGEMENT PRACTICES ON BUSINESS PERFORMANCE: THE CASE OF CHEMICAL INDUSTRY

**Adem ÖĞÜT**
**Selcuk University**

**D. Mehmet BİÇKES-Metin KAPLAN**
**Nevsehir University**

**Emine ÖĞÜT**
**Selcuk University**

## ABSTRACT

*Since there is a multidimensional expansion of the literature in the area of corporate environmental management, the main objective of this paper is to analyze the relationship between the practices of green supply chain management and business performance. In other words, the paper focuses on the relationship between five Green Supply Chain Management (GSCM) practices -including internal environmental management, green purchasing, cooperation with customers, eco-design and investment recovery- and business performance. The findings of the research highlighted that green purchasing had significant and positive relationships with economic and operational performance, there was significant and positive relationship between eco-design and economic performance. Furthermore, investment recovery had significant and positive relationships with environmental and operational performance. Subsequently, the research also noted that the practices of green supply chain management had an effect on business performance.*

***Keywords****: Strategic Performance Management, Green Supply Chain Management, Environmental Management, Chemical Industry*

## INTRODUCTION

The necessity for change has emerged as a vital importance with the industry revolution beginning in the midst of the 19$^{th}$ century. There has been rapid increase in consumption rates by reason of the world population, education and income level of individuals, their improving life standards, through the technological progress making the mass production possible, and the community's tendency to consumption. In response to rising consumption, natural resources used as inputs in manufacturing have been exploited unlimitedly. Humankind controlling the natural resources and directing them has put pressure on environment because of their necessities never lasting. On the one hand, people use the resources needed for the nature to renew itself, on the other hand they dump waste product on environment. In other words, they have both contaminated and destroyed the nature; furthermore, they have got the instruments that are essential for the nature in cleaning and in reshaping. Eventually, the unconscious activities of people have resulted in deterioration of the nature (Lazso, 2003: 54).

People's interests for environmental issues such as pollution, climate change, ozone depletion, changes in flora and fauna (Shrivastava, 1995: 122) have expanded as it never happened before because of the fact that these issues restrict the living areas of people. In parallel with these interests, in the academic standards it has been observed that the researches trying to diminish the impacts of the organizations on environment have increased in numbers (Berry and Rondinelli, 1998; Hart, 1995; Walker, Sisto and McBain, 2008).

Production-consumption centered economic activities lie in the basis of the ecological deterioration (Seymen, 2005: 104); that's why, the parties of the economy have reached a settlement over considering the environmental values to perform the economic activities. Among the consumers, the numbers of individuals conscious of the environment who endeavor to protect the environment with pollution minimization and to enable the preservation of the biological varieties (Mostafa, 2007: 220) have risen constantly (Ay and Yılmaz, 2004: 20). In conjunction with the consumer's tendency, the businesses have to be sensitive to the environment on functions such as supply, design, manufacturing, and marketing.

Environmentally-conscious management defined as aiming the optimum balance between the economic and ecological performance of the businesses, and as a process combining the whole management functions with the protection of the environment (Akdoğan and Aykan, 2008: 123) presents new resources to the businesses for competitive advantage (Gupta, 1995: 36). Environmentally-conscious management changes not only the organization's objectives, values, products and production systems, but also the organization itself, its surrounding and job processes (Shrivastava, 1995: 131). In early environmental management frameworks, the scope of environmentally-conscious management had responsibility for ensuring environmental excellence in logistics, product development, process design, marketing and waste management. Today, this has changed. As in the quality revolution of the 1980s and the supply chain revolution of the 1990s, it has become clear that the best practices call for integration of environmental management with ongoing operations (Srivastava, 2007: 53).

Thanks to the practices of environmentally conscious management, while maintaining the negative impacts of the businesses on environment at the minimum level, they make an effort to save costs, to raise the product quality, and develop the competitive strength at the global level (Porter and Linde, 1995: 121). Environmentally conscious management requires a philosophical conversion and includes all functions of the businesses. One of these functions, supply is vital for environmentally-conscious management as it directs all the components used as inputs in the manufacturing process of the business, manufacturing process and outputs formed in the manufacturing outcome.

**Green supply chain management** has emerged as an important new archetype for enterprises to achieve profit and market share objectives by reducing environmental risk and impact (Hu and Hsu, 2006: 853). Green supply chain management is defined as "integrating environmental thinking into supply chain management, including product design, material sourcing and selection, manufacturing processes, delivery of the final product to the consumers as well as end-of-life management of the product after its useful life" (Srivastava, 2007: 54-55). The growing importance of green supply chain management is driven mainly by the escalating deterioration of the environment, e.g. diminishing raw material sources, overflowing waste sites and increasing levels of pollution.

Given that there is a multidimensional expansion of the literature in the area of corporate environmental management (Zhu, Sarkis and Lai, 2008a: 263), this paper focuses on five GSCM practices including internal environmental management, green purchasing, cooperation with customers, eco-design and investment recovery. Internal environmental management is a key to improving enterprises' performance (Zhu, Sarkis and Geng, 2005: 453). Environmental management encompasses diverse initiatives to reduce or minimize the adverse environmental impacts of an organization's operations. These efforts aim to improve environmental performance, reduce costs, enhance corporate image, reduce risks of non-compliance and improve marketing advantage (Rao and Holt, 2005: 906). Green purchasing is defined as purchasing's involvement in supply chain management activities in order to facilitate recycling, reuse, and resource reduction (Carter, Ellram and Ready, 1998: 29).Cooperation with customers states the businesses interaction with the conscious customers in the process of design, manufacturing and packaging. Eco-design refers to address product functionality while simultaneously minimizing life-cycle environmental impacts. The success of eco-design requires internal cross-functional cooperation within the company and the external cooperation with other partners throughout the supply chain (Zhu, Sarkis and Lai, 2008b: 3-4). Without green purchasing and customer cooperation practices, product take-back and other product reintroduction markets may not become as developed. Investment recovery covers leaning of the business processes and selling off the disused items such as overstock, waste.

Business Performance, which reflects the perspective of strategic management, is a subset of the overall concept of organizational effectiveness (Venkatraman and Ramanujam, 1986: 803) and can be defined as the achievement of organizational goals related to profitability and growth in sales and markets share, as well as the accomplishment of general firm strategic objectives (Hult, Hurley and Knight, 2004: 430-431). Business performance can be measured using the environmental, economic and operational indicators (Zhu, Sarkis and Lai, 2008a: 271-272).

It is generally perceived that green supply chain management promotes efficiency and synergy among business partners and their lead corporations, and helps to enhance environmental performance, minimize waste and achieve cost savings. This synergy is expected to enhance the corporate image, competitive advantage (Rao and Holt, 2005: 899). In the literature, it is also emphasized that the practices of green supply chain management have an impact on the business performance and the competitive strength. Chow et al. (2008), found that supply chain practices had direct impact on organization performance in Taiwan. Vachon and Klassen (2008) found a positive link between environmental collaboration among organizations in the supply chain and both manufacturing and flexibility performance. Rao and Holt (2005) noted that green supply chain led to increased competitiveness and better economic performance. Zhu and Sarkis (2004) found a positive relationship between green supply chain practices implementation and environmental and economic performance as well.

In the light of the explanations above, the research question is the following: Do the practices of green supply chain management have an impact on improving the business performance? At this framework here, the aim of the research is to find out whether there is a significant relationship between the practices of green supply chain management and the business performance as well as the efficacy level of green supply chain management practices on the business performance.

# METHODOLOGY

**Sample**

The sampling of the research is presented by the businesses operating in the sector of plastic, paint and chemistry in the industrial zone of Konya, Turkey. Having the great industry potential, the research is limited with the city of Konya. 60 firms registered to the Chamber of Konya Industry which have operations in the sector of plastic, paint and chemistry took place in this research. 60 questionnaires were distributed. 56 questionnaires were returned. This represented an overall response rate of 93.3%.

**Measurement**

A semi-structured survey has been utilized as a data-gathering technique. The scales developed by Zhu, Sarkis and Lai (2008a) has been used in order to measure green supply chain management practices and the impacts of the practices on the business performance. A questionnaire consists of three sections.

The first section includes internal environmental management, green purchasing, cooperation with customers, eco-design and investment recovery by using a five-point Likert-type Scale (1= not considering it, 2= planning to consider, 3= considering it currently, 4= initiating implementation, 5= implementing successfully) with 20 measurement items to measure green supply chain management practices of the businesses. Cronbach's alpha were as follows: 0.87 for internal environmental management, 0.80 for green purchasing, 0.90 for cooperation with customers, 0.84 for eco-design and 0.83 for investment recovery.

The second section deals with the business performance outcomes in terms of three dimensions- environmental, economic and operational performance- by using a five-point Likert-type Scale (1= not at all, 2= a little bit, 3= to some degree, 4= relatively significant, 5= significant) with 17 measurement items. Cronbach's alpha were as follows: 0.75 for environmental performance, 0.76 for economic performance and 0.73 for operational performance. In the third section, the questions are related to the type and nature of business.

**Independent variable**: Green supply chain management practices (internal environmental management, green purchasing, cooperation with customers, eco-design and investment recovery)

**Dependent variable**: Business performance outcomes (environmental, economic and operational performance).

**The model and hypothesis of the research are as follows:**

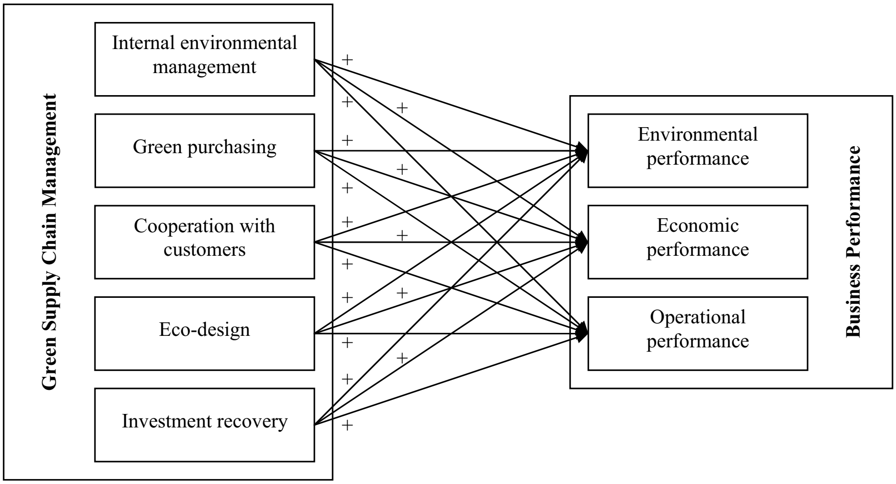



**Figure 1.** Research Model

**$H_1$:** There is a positive relationship between the internal environmental management which is one of the practices of green supply chain management and environmental performance of the business.
**$H_2$:** There is a positive relationship between the green purchasing which is one of the practices of green supply chain management and environmental performance of the business.
**$H_3$:** There is a positive relationship between the cooperation with customers which is one of the practices of green supply chain management and environmental performance of the business.
**$H_4$:** There is a positive relationship between the eco-design which is one of the practices of green supply chain management and environmental performance of the business.
**$H_5$:** There is a positive relationship between the investment recovery which is one of the practices of green supply chain management and environmental performance of the business.
**$H_6$:** There is a positive relationship between the internal environmental management which is one of the practices of green supply chain management and economic performance of the business.
**$H_7$:** There is a positive relationship between the green purchasing which is one of the practices of green supply chain management and economic performance of the business.
**$H_8$:** There is a positive relationship between the cooperation with customers which is one of the practices of green supply chain management and economic performance of the business.
**$H_9$:** There is a positive relationship between the eco-design which is one of the practices of green supply chain management and economic performance of the business.
**$H_{10}$:** There is a positive relationship between the investment recovery which is one of the practices of green supply chain management and economic performance of the business.
**$H_{11}$:** There is a positive relationship between the internal environmental management which is one of the practices of green supply chain management and operational performance of the business.
**$H_{12}$:** There is a positive relationship between the green purchasing which is one of the practices of green supply chain management and operational performance of the business.
**$H_{13}$:** There is a positive relationship between the cooperation with customers which is one of the practices of green supply chain management and operational performance of the business.
**$H_{14}$:** There is a positive relationship between the eco-design which is one of the practices of green supply chain management and operational performance of the business.
**$H_{15}$:** There is a positive relationship between the investment recovery which is one of the practices of green supply chain management and operational performance of the business.

The hypotheses of the research were tested via the correlation analysis. In addition, the regression analysis was put into practice so as to determine the efficacy level of the green supply chain management practices (determination coefficient=$R^2$) on the business performance outcomes.

# DATA ANALYSIS AND RESULTS

In the research, 48.2% of the businesses have been serving in the plastic sector, 28.6% in the paint sector and 23.2% in the chemistry sector. 48.2% of the businesses have been serving in national marketing, 44.6% in international marketing and 7.1% in regional marketing. 85.7% of the businesses were administered by the business owners, 60.7% of them employed less than 49 employees.

Table 1 shows the means, standard deviations, variables in the study associated with the subset of the business performance that are environmental performance, economic performance, and operational performance, the subdivisions of the practices of green supply chain management including internal environmental management, green purchasing, cooperation with customers, eco-design, investment recovery.

**Table 1.** Means, standard deviations, coefficient alphas and correlations for study variables.

| VARIABLES | Mean | Std. Dev. | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|---|---|
| **1**.Internal environmental man. | 3.15 | 0.96 | *(.87)* | | | | | | | |
| **2.** Green purchasing | 3.23 | 0.90 | .12 | *(.80)* | | | | | | |
| **3**. Cooperation with customers | 3.39 | 1.13 | .13 | .16 | *(.90)* | | | | | |
| **4**. Eco-design | 3.73 | 1.20 | .03 | .19 | .19 | *(.84)* | | | | |
| **5**. Investment recovery | 3.04 | 0.91 | .36** | .20 | .04 | .28* | *(.83)* | | | |
| **6.** Environmental performance | 3.80 | 0.71 | -.09 | .23 | .19 | .11 | .28* | *(.75)* | | |
| **7**. Economic performance | 3.93 | 0.65 | -.01 | .28* | .05 | .31* | .24 | .31* | *(.76)* | |
| **8**. Operational performance | 3.94 | 0.59 | .18 | .29* | .16 | .23 | .32* | .23 | .29* | *(.73)* |

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

As shown in Table 1, as a result of Pearson correlation analysis green purchasing had significant and positive relationships with economic performance ($r=0.28$, $p<0.05$) and operational performance ($r=0.29$, $p<0.05$). These results supported $H_7$ and $H_{12}$. There was significant and positive relationship between eco-design and economic performance ($r=0.31$, $p<0.05$). According to this result, $H_9$ was accepted. Likewise, investment recovery had significant and positive relationships with environmental performance ($r=0.28$, $p<0.05$) and operational performance($r=0.32$, $p<0.05$). According to these findings , $H_5$ and $H_{15}$ were supported. In this frame, these results were consistent with the study results of Rao and Holt (2005) and Zhu and Sarkis (2004). Not any significant relationships were found among other variables. In this respect, $H_1$, $H_2$, $H_3$, $H_4$, $H_6$, $H_8$, $H_{10}$, $H_{11}$, $H_{13}$ and $H_{14}$ were turned down.

The regression analysis was carried out to determine the efficacy level of the practices of green supply chain management on the business performance.

**Table 2**. Results of regression analysis.

| Independent Variable | $R^2$ | Adjusted $R^2$ | F | Beta | S. E. | t value | Sig. |
|---|---|---|---|---|---|---|---|
| GSCM | .190 | .175 | 12.629 | .435 | .429 | 3.554 | .001 |

$p<0.05$; Dependent variable: Business performance

As for the analysis results (Table 2); the practices of green supply chain management had an effect on business performance. This finding was similar with the study results of Chow et al. (2008). Besides, determination coefficient (adjusted $R^2$) 0.175 was estimated and it indicated that 17.5% of the business performance change was dependent on the practices of green supply chain management. The positive value of Beta coefficient ($\beta=0.435$), ascertained positive relationship between variables. In other words, it is possible to express that the more the practices of green supply chain management increases, the more business performance increases.

To be environmentally-conscious in the phase of designing, supply, manufacturing and marketing are the necessary needs in terms of sustainable development. The recommendations of the search can be categorized in the following headings:

- Environmental consciousness can both exist as a significant indicator of the social responsibilities and regarded as the result of the regulations and market conditions though. Thus, environmentally-conscious businesses can contribute to the other business to enhance their reputation in relation to social responsibility behavior taking place in the chain of supply.

- Even though the implementations of environmentally conscious management caused a rise in the cost initially, later they have produced a lot of positive results for businesses, society and environment within the middle and long terms. In all their affairs, businesses should act sensitive towards the environment in the way of modern management conception.
- The conception of environmentally-conscious management is a complete phenomenon. Making only one of the business functions environmentally conscious is not sufficient to get benefit. All functions, from designing to supply and manufacturing to marketing should be made environmentally conscious.
- The businesses, implementing environmentally-conscious management have become disadvantageous against their rival businesses. The regulations and controls must be realized to protect those businesses, acting in the favor of social responsibilities and to make the others act in the favor of this conception.
- Environmental consciousness is a social even a global issue. The success of this philosophy depends on existence of all sides, adopting the issue and forming the economic system. It should be well explained that they would gain great benefits in the middle and long terms after they have had some struggles in the short term.

# REFERENCES


Akdoğan, A. A. and Akyan, E. (2008), Çevre duyarlı insan kaynakları yönetimi, *16. Ulusal Yönetim ve Organizasyon Kongresi Bildiriler Kitabı*, İstanbul Kültür Üniversitesi, (16-18 May): 123-133.

Ay, C. and Yılmaz, E. (2004), Yeşil pazarlama ve serel seramik A.Ş.'nin yeşil uygulamaları, *Sosyal Bilimler*, 2(2): 17-27.

Berry, M. A. and Pondinelli, D. A. (1998), Proactive corporate environmental management: A new industrial revolution, *Academy of Management Executive,* 12(2): 38-50.

Carter, C.R., Ellram, L.M. and Kathryn, L.M. (1998), Environmental purchasing: benchmarking our German counterparts, *International Journal of Purchasing & Materials Management*, 34(4): 28-38.

Chow, S. Wing; Madu, N. Christian; Kuei, Chu-Hua; Lu, H. Min; Lin, Chinho and Tseng Houjung (2008), Supply chain management in the US and Taiwan: An empirical study, *Omega The International Journal of Management Science,* 36: 665-679.

Gupta, M. C. (1995), Environmental management and its impact on the operations function, *International Journal of Operations & Production Management*, 15(8): 34-51.

Hart, S. L. (1995), A natural-resource based view of the firm, *Academy of Management Review,* 20(4): 986–1014.

Hu, A.H. and Hsu, C.W. (2006), Empirical study in the critical factors of supply chain management (GSCM) practice in the Taiwanese electrical and electronics industries, *IEEE International Conference on Management of Innovation and Technology*, 853-857.

Hult, G.T.M., Hurley, R.F. and Knight, G.A. (2004), Innovativeness: Its antecedents and impact on business performance, *Industrial Marketing Management*, 33: 429-438.

Laszlo, E. (2003), Makro değişim: Sürdürülebilir bir dünyaya dönüşümü yönetmek, Translator: Murat Abuş, Mopa Kültür Yayınları, İstanbul.

Mostafa, M. M. (2007), Gender differences in Egyptian consumers' green purchase behavior: The effects of environmental knowledge, concern and attitude, *International Journal of Consumer Studies,* (31): 220-229.

Porter, M. E. and Claas van der Linde. (1995), Green and competitive, *Harvard Business Review*, (September-October): 120-134.

Rao, P. and Holt, D. (2005), Do green supply chains lead to competitiveness and economic performance?, *International Journal of Operations & Production Management,* 25(9): 898-916.

Seymen, D. (2005), Dış ticaret-çevre ilişkilerinin dengelenmesi: Sürdürülebilir ticaret, teori ve Türkiye değerlendirmesi, *Dokuz Eylül Üniversitesi Sosyal Bilimler Enstitüsü Dergisi,* 7(3): 99-127.

Shrivastava, P. (1995), Ecocentric management for a risk society, *Academy of Management Review,* 20(1): 118-137.

Srivastava, S. K. (2007), Green supply chain management: A state of the art literature review, *International Journal of Management Reviews,* 9(1): 53-80.

Vachon, S. and Klassen, R. D. (2008), Environmental management and manufacturing performance: The role of collaboration in the supply chain, *International Journal of Production Economics,* (111): 299-315.

Venkatraman, N. and Ramanujam, V. (1986), Measurement of business performance in Strategy Research: A Comparison of Approaches, *Academy of Management Review*, 11(4): 801-814.

Walker, H., Sisto, L. D. and McBain, D. (2008), Drives and barriers to environmental supply chain management practices: Lessons from the public and private sectors, *Journal of Purchasing & Supply Management,* (14): 69-85.

Zhu, Q. and Sarkis, J. (2004), Relationships between operational practices and performance among early adopters of green supply chain management practices in Chinese manufacturing enterprises, *Journal of Operations Management,* 22 (3): 265–289.

Zhu, Q., Sarkis, J. and Geng, Y. (2005), Green supply chain management in China: pressures, practices and performance, *International Journal of Operations & Production Management*, 25(5): 449-468.

Zhu, Q., Sarkis, J. and Lai, K. (2008a), Confirmation of a measurement model for green supply chain management practices implementation, *International Journal of Production Economics,* (111): 261-273.

Zhu, Q., Sarkis, J. and Lai, K. (2008b), Green supply chain management implications for "closing the loop", *Transportation Research Part E*, 44: 1-18.

Zhu, Q., Sarkis, J., Cordeiro, James J. and Lai, K. (2008), Firm-level correlates of emergent green supply chain management practices in the Chinese context, *The International Journal of Management Science,* (36): 577-591.

# LOYALTY EXISTS IN FUEL CONSUMPTION OR DOES NOT?

**Ceyda Aysuna, Uğur Yozgat, Sahavet Gürdal,**
**Marmara University, TURKEY**

## ABSTRACT

*In today's tough competitive environment where product variety is very high, companies follow different strategies to be "the preferred one". This is necessary for them to survive and to be successful in such an environment. But it's not enough to be "the preferred one". Attracting customers provides a growth in sales and profit but only in the short run. Thus it becomes vital for companies to retain customers once they attract them. In other words, making customers loyal is the most important factor affecting firms' success and sustainability. This paper focuses on loyalty for gas station brands. The purpose of the study is to reveal whether loyalty exists for fuel brands among fuel product consumers or not. It also aims to define the factors leading loyalty and their relative effect on loyalty. Knowing these factors help companies operating in this sector to rearrange their loyalty programs and gives clues about converting customers to loyal customers. This will definitely lead to higher customer satisfaction, higher market share, higher profits and in the end more competitive advantage in national and also in international markets.*

***Keywords:*** *Consumers, loyalty, fuel products.*

## INTRODUCTION

Because of the growing intensity of competition, companies' aims have been changed over the last few years. Firms were focusing on attracting new customers in the past but today's marketing strategies are concentrated on securing and improving customer loyalty (Bruhn and Grund, 2000). There are several reasons for this important change. But maybe the most important reason of this change is about the cost of attracting new customers. It has been accepted and realized that it's more expensive to attract new customers than retaining the existing ones. As a result of this, companies operating both in national and international markets started pay more attention and these subjects become more important

Besides the importance of loyalty, there are several factors affecting it (Punniyamoorthy and Raj, 2007). These factors can be divided into two groups named as intrinsic factors that marketers have direct influence on and extrinsic factors that marketers have indirect or no influence (Gentry and Kalliny, 2008). Determining these factors and knowing them is crucial for companies to gain competitive advantage over their rivals.

This paper firstly examines the definitions of loyalty and defines what it means for companies. Later on, the advantages offered by loyalty are discussed. Following this, the factors leading loyalty are defined and classified. In the second part of the study a research about gas station brands is conducted aiming to reveal whether loyalty exists for fuel products brands and if it does to determine the level of loyalty. The last part of the research defines the factors leading loyalty for gas station brands and their relevant importance.

## DEFINING LOYALTY

According to the review of the brand literature, it seems to be that Copeland (1923) is the first who mentioned a concept related to "brand loyalty" which he called as "brand insistence" In his study he described the theoretical relationship between brands and consumers' buying habits (Lau and Lee, 1999; Gentry and Kalliny, 2008). After this first study related to brand loyalty, numerous studies have taken place in brand literature.

The examination of these studies brings up the fact that brand loyalty has not been uniquely defined in the literature. Many definitions such as repeat purchase (Ehrenberg, 1988), preference (Guest, 1994), retention, allegiance (Thiele & Mackay, 2001) and so on exist. These different types of definitions of loyalty are due to the complex and multidimensional structure of the concept (Gounaris and Stathakopoulos, 2004; Javalgi and Moberg, 1997).

Besides, Aaker (1991) defines brand loyalty as a measure of attachment that a customer has to a brand. One other researcher called Oliver (1999) defines the concept as "a deeply held commitment to rebuy or repatronise a preferred product / service consistently in the future, thereby causing repetitive same-brand or same brand-set purchasing, despite situational influences and marketing efforts are having the potential to cause switching behavior".

The definitions discussed above and the others mentioned in the literature point out the fact that loyalty has behavioral and emotional / attitudinal aspects. This can be seen clearly from Oliver's (1999) definition. Also according to Chen and Tsai (2008) "loyalty comprises both attitudinal and behavioral measures. The attitudinal measure of customer loyalty refers to a specific desire to continue a relationship with a product / service provider while the behavioral perspective refers to the concept of repeat patronage". Similarly, Dick and Basu (1994) suggest that loyalty is the result of a more favorable attitude and a repeat purchase behavior. It means that continuously buying the same brand or shopping from the same store merely doesn't denote loyalty. To talk about loyalty emotions suck as liking, trusting, belonging to, preferring should also exist for the customer. Supporting this idea in their research Gremler and Brown (1996) have found out that approximately 75 per cent of customers' purchasing decision is based on their emotion and attitude (Punniyamoorthy and Raj, 2007).

Referring to the behavioral and attitudinal aspects of loyalty Bloemer and Kasper (1995) classify loyalty into two groups named as "true loyalty" and "spurious loyalty". According to the authors, "true loyalty implies a true commitment to the brand in addition to repetitive purchasing". This means that if this true commitment doesn't exist customers can switch to other brands/stores easily when confronted with a lower price, discount etc. Therefore, denying the emotional aspects is nearly impossible when considering and also measuring loyalty.

## THE IMPORTANCE OF LOYALTY

There are several reasons that can explain the importance of loyalty for companies both operating nationally and internationally. Because of the more complex and uncertain nature of international markets compared to national ones loyalty gains more important for international companies. No matter in which market the company operates the reasons making loyalty important are common and can be summarized as follows:

- According to Reichheld (1996) loyalty reduces the need to incur customer acquisition costs (Thiele and Mackay, 2001). As mentioned before in previous studies it has been proved that acquiring new customers is most costly than retaining the current ones.
- Loyalty can lead to favorable responses by creating positive word of mouth (Dick and Basu, 1994).
- Loyalty leads less reliance on negative information that may change the current attitude (Meyer, 2008).
- Loyal customers mean greater sales, more market share and much profit.
- Loyal customers will also oppose greater resistance to competitors' brands and marketing activities even if they provide more attractive offers.
- It enables brand extensions which means due to the trust and belief to the brand loyal customers will have no or little doubt when buying the extended brands.

A survey conducted by Bain & Co. (Reichheld and Teal, 2001) in fact summarizes and proves the advantages provided by loyalty. The survey shows that a 5% increase in customer loyalty can increase a company's profitability by 40-95 %, and an increase in customer loyalty of 1 % is the equivalent of a 10% cost reduction (Kim, Morris and Swait, 2008).

Loyalty doesn't provide advantages only for the companies. Similarly it provides essential benefits for consumers. According to Kim, Morris and Swait (2008) "for consumers, a brand toward which they feel loyal can act as a signal of achieved expectation. Because of the familiar and favorable signal that the brand sends, consumers buy the brand with more comfort, believing and trusting the brand will meet their expectations and will satisfy them".

Depending on all these reasons pointing out the importance of loyalty, it can be concluded that loyalty is a fundamental concept in strategic marketing and also in management. Because companies often develop strategies and marketing programs to acquire more loyal customers.

# TYPES OF LOYALTY

Loyalty can be classified on the basis of several different factors. One of them is the thing the customers are loyal to. On the basis of this criterion loyalty can be grouped as brand loyalty and store loyalty. Brand loyal customers purchase the same brand continuously with favorable emotions while store loyal customers visit the same store of the brand with the same favorable attitudes and emotions. This doesn't mean that a brand loyal customer is also a store loyal customer. The customer can be loyal to the brand but can do his/her shopping from different stores of the brand. Because of this reason while studying loyalty the dissimilarity between these two types of loyalty should be taken into consideration.

Another classification can be done on the basis of the degree of loyalty. According to the classification of Gentry and Kalliny (2008), loyalty can be grouped as aloyalty, inert loyalty and active loyalty. The authors define aloyalty as the case of lack of loyalty and state that it is composed of "promiscuity" where nearly no loyalty exists and "little loyalty". When the inert loyalty is examined it is seen that the name derives from the assumption that most customers are repeat customers due to habit or inertia. In other words, in this type of loyalty behavioral aspects of loyalty are dominant compared to attitudinal aspects. Also it is accepted that most consumers are expected to fall in this part of the classification. Finally, according to the authors active loyalty is used for the customers whose loyalty coefficients are high in terms of both behavioral and attitudinal aspects of loyalty. And active loyalty is composed of high loyalty and ultimate loyalty.

According to another study, four types of loyalty are defined which are called no loyalty, covetous loyalty, inertia loyalty and premium loyalty. As the name suggests no loyalty refers to no purchase and a complete lack of attachment to the brand. Covetous loyalty means no purchase but a high level of attachment to the brand due to the social influences. In inertia loyalty the individual purchases the brand due to habit, convenience or some other reason but certainly not as a consequence of emotional attachment to the brand. And finally in premium loyalty customer purchases the brand frequently and exhibits a high level of attachment to the brand (Gounaris and Stathakopoulos, 2004).

# MEASURING OF LOYALTY

Before measuring loyalty the factors affecting it or in other words the determinants of it should be known. Therefore this section first examines the factors related to loyalty and then defines measures used to assess loyalty.

## Determinants of Loyalty

It is possible to classify the factors of loyalty as extrinsic and intrinsic factors. Extrinsic factors are the ones which marketers have indirect or no influence whereas intrinsic factors are the factors generally within the direct control of marketing managers.

The extrinsic factors of loyalty are resistance to change, double jeopardy - which means other things being equal small brands attract less loyalty because they are small and less known (Ehrenberg, Goodhart and Barwise, 1990) - pioneering advantage (expected to create higher levels of loyalty), regulatory disadvantage (sometimes regulations can prevent some customers to be loyal to a firm/brand), boycott of competitor(s), ownership and involvement. Furthermore social worlds, satisfaction, perceived offerings, loyalty programs and exposure to employees (treatment of employees to customers can make them to be loyal) are the examples of intrinsic factors (Gentry and Kalliny, 2008).

Whether they are extrinsic or intrinsic these factors affect loyalty and to measure it they must be taken into account. When looking at the subject from the managerial view point it is obvious that to increase the level of loyalty or the number of loyal customers managers should pay more attention on intrinsic factor which they have direct influence.

## Loyalty Measures

Review of the loyalty literature points out that researchers have made different classifications of loyalty measures. The classification made by Mellens et al. (1996) depends on the behavioral and attitudinal aspects of the concept and can be summarized as follows (Thiele and Mackay, 2001);

- *Behavioral Loyalty Measures:* These measures define loyalty in terms of actual purchases observed over a time period.

- *Attitudinal Loyalty Measures:* They are based on stated preferences, commitment, attitudes and purchase intentions and probability of purchases.

Another study by Punniyamoorthy and Raj (2007) identifies brand loyalty measures as involvement, perceived value which is composed of functional value, social value and emotional value, brand trust, customer satisfaction and finally repeated purchase behavior. In addition to these measures Caceres and Paparoidamis (2007) suggest that quality is one of the factors leading loyalty.

Measures of loyalty and the factors affecting it can't be thought independently because they interact with each other. In other words, in order to measure the level of loyalty both the measures it and the factors affecting and/or leading it should be taken into consideration.

# RESEARCH DESIGN

The research part of this paper has two main purposes. First aim of it is to determine the level of loyalty. The second aim of the study is to define the factors causing this loyalty level.

## The Scope and Limitations of the Study

The scope of the study consists of car drivers. The important point here is that only passenger car drivers are included and commercial vehicle drivers are excluded from the study.

There are three major limitations of this study. First of all, only the passenger car drivers are included in the study. Secondly, the survey has conducted in İstanbul. These mean that only passenger car drivers in İstanbul are candidates of the sample of this survey. Finally, the loyalty mentioned in the study only covers up the brand loyalty (store loyalty is excluded).

## Data Collection Method

Since as a data collection method "drop off questionnaire method" is used in the study implying that questionnaires were distributed to subjects and a reasonable amount of time has left them to fill the questionnaires and then collected back.

In order to reach the subjects of the study, convenience sampling method was used which is one of the non probability sampling methods. 1400 questionnaires were distributed and 681 of them returned pointing at a response rate of 47.29 %. Among 681, 622 (91.34 %) questionnaires were included in the statistical analysis. The others were discarded because of missing variables and inconsistent answers.

## Survey Instrument and Scale Development

The questionnaire used in the study consists of three parts. The scale which aims to define the factors that affect consumers' gas station brand choices takes place in the first part of the questionnaire and consists of 23 items (one item was discarded depending on the analysis results). In the second part of the study another scale consisting of 6 items is used to measure the level of loyalty for gas station brands. Finally the last part of the questionnaire includes five demographic questions.

In order to develop the first scale using to define the factors affecting consumers' gas station brand choices a focus group survey has conducted. 8 people participated in the focus group whose ages were between 25 and 50. University students, academicians and people working in the public sector participated in the focus group.

The results of the focus group are combined with the results of the literature survey and in the next step, as for the "face validity" the scale was assessed by 3 colleagues working in the management and marketing fields.

The second scale in the questionnaire named as the loyalty scale was adopted from the two loyalty scales which were developed by Kim, Jin and Swinney (2008) and Punniyamoorthy and Raj (2007). The face validity of the scale was again checked by the same way.

## Pilot Study

In order to test the questionnaire in terms of wording and to reveal whether it is comprehensible or has unclear parts a pilot study with a sample of 30 was conducted. Following the pilot study some minor corrections were made such as the word "loyalty card" was changed as "gas stations' own card" because some people failed to understand what loyalty card means. And beside the phrase "credit card advantages" parenthesis were put and the meaning of it was explained in detail in it. Because no new suggestions and complaints came up the pilot study was finished after 30 people.

# RESEARCH FINDINGS

## Demographic Characteristics

When the demographic characteristics of the subjects are examined, it is seen that 36.3 % of them were female whereas 63.7 % were males. The mean of the age of the respondents is 37.23. The results of gender and income levels of the subjects are summarized in Table 1.

**Table 1. Demographic Characteristics of the Respondents**

| | Frequency | Valid Percent |
|---|---|---|
| **Gender** | | |
| Female | 226 | 36.3 |
| Male | 396 | 63.7 |
| ***Total*** | ***622*** | ***100.0*** |
| **Income** | | |
| 0 - 499 TL | 14 | 2.3 |
| 500 - 999 TL | 74 | 12.1 |
| 1,000 – 1,499 TL | 131 | 21.4 |
| 1,500 – 1,999 TL | 128 | 20.9 |
| 2,000 – 2,499 TL | 77 | 12,6 |
| 2,500 – 2,999 TL | 35 | 5,7 |
| 3,000 – 3,499 TL | 27 | 4,4 |
| 3,500 – 3,999 TL | 25 | 4,1 |
| 4,000 TL and over | 100 | 16,4 |
| ***Total*** | ***611*** | ***100,0*** |

In the second part of the demographic variables, the characteristics of the passenger cars of the respondents are examined. They are summarized in Table 2, in terms of the age of the car, km of the car, and the km traveled per year by the car.

**Table 2. Characteristics of Respondents' Cars**

| | Mean | Std. Dev. |
|---|---|---|
| Age of The Car | 5.30 | 4.02 |
| Km | 74,530.17 | 55,163.34 |
| Km per year | 15,723.50 | 10,311.59 |

## Assessment of the Reliability

The reliability of the scale has been assessed by alpha coefficient. The reliability analysis produced an acceptable level of 0.7984 for the first scale which determines the factors affect brand choice. For the second scale which is the loyalty scale the cronbach's alpha level is 0.8370. These levels are determined to be acceptable according to Nunnally (1979).

## Factor Analysis

A factor analysis has been conducted before further analyses for the purposes of data reduction and classification of the factors effective on brand choice. Kaiser-Meyer-Olkin (KMO) measuring sampling adequacy result is 0.770 which is an acceptable value for conducting factor analysis. Significance of Bartlett's test of sphericity is 0.00 that is also acceptable for conducting factor analysis.

When the factor loadings of the factors are examined, because of the low factor loading one item which is about price is excluded. Principal components analysis (varimax rotation) produced 7 factors as can be seen below.

**Table 3. Factor Analysis**

| Factors | Factor-loads | Eigen-value | % of Variance explained | Cum. % of Var. explained | Cronbach's alpha |
|---|---|---|---|---|---|
| ***Loyalty*** | | 3,385 | 12,088 | 12,08 | ,837 |
| I feel loyal to this brand. | ,792 | | | | |
| I don't think to change my gas station brand preference. | ,790 | | | | |
| For me this gas station is the best brand to prefer. | ,774 | | | | |
| This brand is my first choice when I need gas. | ,703 | | | | |
| This gas station brand never disappoints me. | ,686 | | | | |
| When I need gas, I keep on looking for this brand till I find it. | ,654 | | | | |
| ***Factor 1: Sales Promotions*** | | 2,344 | 8,371 | 20,45 | ,757 |
| The existence of gas station's own card affects me to choose this gas station brand. | ,775 | | | | |
| Promotional activities are effective on my gas station brand choice. | ,723 | | | | |
| The availability of the usage of the gas station's own cars in other companies affects my brand choice. | ,704 | | | | |
| Credit card advantages (payment conditions etc.) affect my gas station brand preference. | ,704 | | | | |
| ***Factor 2: Service Quality*** | | 2,157 | 7,704 | 28,16 | ,761 |
| The cleanliness of the gas station's toilettes plays an important role on my brand choice. | ,796 | | | | |
| The cleanliness of the gas station plays an important role on my brand choice. | ,775 | | | | |
| The friendliness of the employees working at the gas station is affective form e to choose this brand. | ,580 | | | | |
| Respectful employees positively affect my brand preference. | ,498 | | | | |

**Table 3. Factor Analysis (cont.)**

| Factors | Factor-loads | Eigen-value | % of Variance explained | Cum. % of Var. explained | Cronbach's alpha |
|---|---|---|---|---|---|
| ***Factor 3: Brand Awareness*** | | 1,970 | 7,037 | 35,20 | ,602 |
| Customer intensity in the gas station positively affects my brand preference. | ,664 | | | | |
| Suggestions and comments about the gas station brand coming from my social environment affect my brand choice. | ,663 | | | | |
| The product variability of the market in the gas station affects my brand preference. | ,654 | | | | |
| The advertisement of the gas station brand directs me to choose the brand. | ,512 | | | | |
| ***Factor 4: Product Quality and Distribution*** | | 1,858 | 6,637 | 41,83 | ,608 |
| Gas quality is effective on my brand selection. | ,788 | | | | |
| Trust on brand affects my choice. | ,677 | | | | |
| The high appearance frequency of gas station's branches is an important factor on my brand choice. | ,494 | | | | |
| ***Factor 5: Social Responsibility*** | | 1,838 | 6,565 | 48,40 | ,621 |
| Gas station's participation in social responsibility activities is an incentive form e to choose this gas station brand. | ,787 | | | | |
| Gas station brand's sensitiveness against the environment affects my brand choice. | ,684 | | | | |
| Gas station's sponsorship activities act as an incentive for me to choose this gas station brand. | ,642 | | | | |
| ***Factor 6: Additional Service and Support*** | | 1,828 | 6,529 | 54,93 | ,802 |
| The existence of car washing service plays an important role on my gas station brand preference. | ,852 | | | | |
| The existence of ***free*** car washing service plays an important role on my gas station brand preference. | ,827 | | | | |
| ***Factor 7: Situational Factors*** | | 1,773 | 6,334 | 61,26 | ,632 |
| The ease of entrance of the gas station affects me to choose that gas station brand. | ,811 | | | | |
| I prefer to shop from the gas station if it is on my route. | ,678 | | | | |

*Kaiser-Meyer-Olkin Measure of Sampling Adequacy = ,770*
*Bartlett's Test of Sphericity (Approx. Chi-Square = 5035,21, df = 378, Sig.= ,000)*

**Table 4. Pearson Correlations Table**

| | Mean | Std. Dev. | Loyalty | F1 | F2 | F3 | F4 | F5 | F6 |
|---|---|---|---|---|---|---|---|---|---|
| **Loyalty** | 3,60 | ,72 | | | | | | | |
| **F1** | 3,18 | ,91 | ,014 | | | | | | |
| **F2** | 3,75 | ,73 | ,137** | ,199** | | | | | |
| **F3** | 2,90 | ,70 | ,079 | ,248** | ,230** | | | | |
| **F4** | 3,96 | ,67 | ,312** | ,127** | ,363** | ,060 | | | |
| **F5** | 3,35 | ,70 | -,037 | ,361** | ,186** | ,206** | ,081* | | |
| **F6** | 3,68 | ,98 | ,157** | ,163** | ,310** | ,240** | ,332** | ,130** | |
| **F7** | 3,45 | ,96 | -,104* | ,196** | ,279** | ,101* | ,063 | ,274** | ,114** |

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

The following table summarizes the two questions of the questionnaire that are related to the gas station brand preferences. The left part of the table is the answer of the question; “Name the gas station brand you most frequently buy fuel products?” According to the results, 228 of the respondents cite the brand “Shell”, while 164 of them “BP” and 128 “Opet”. When the brands are ranked according to their loyalty levels (consisting of the brands preferred by more than 100 people) Shell is on the top (with a mean of 3.74), followed by Opet (with a mean of 3.60).

The right part of the table is the answer of the question; “List in order the gas station brands you prefer”. The results show that 237 people rank Shell, while 154 rank BP, and 142 Opet as their first choice.

**Table 5. Preferences and Ranking of Gas Station Brands**

| | Preference | Loyalty | | Rank | | | | | *Total* |
|---|---|---|---|---|---|---|---|---|---|
| | | Mean | Std.Dev. | 1 | 2 | 3 | 4 | 5 | |
| **Shell** | 228 | 3.74 | .68 | 237 | 144 | 61 | 12 | 1 | ***455*** |
| **BP** | 164 | 3.47 | .70 | 154 | 168 | 61 | 14 | - | ***397*** |
| **Opet** | 128 | 3.60 | .76 | 142 | 101 | 66 | 10 | 3 | ***322*** |
| **Petrol Ofisi** | 69 | 3.36 | .79 | 71 | 64 | 70 | 22 | 1 | ***228*** |
| **Total** | 20 | 3.64 | .58 | 22 | 34 | 35 | 19 | 5 | ***115*** |
| **Türk Petrol** | 5 | 3.83 | .55 | 12 | 9 | 8 | 5 | - | ***34*** |
| **Akpet** | 5 | 3.57 | .95 | 5 | 4 | 4 | 4 | 1 | ***18*** |
| **Alpet** | 1 | 2.83 | - | 2 | 7 | 4 | 3 | - | ***16*** |
| **Moil** | 2 | 3.58 | .59 | 2 | 1 | 1 | 1 | 2 | *7* |
| ***Total*** | ***622*** | ***3.60*** | ***.72*** | | | | | | |

# Regression Analysis

In order to determine the effect of the brand preference factors on loyalty, step-wise regression analysis is conducted. Based on the results of the regression analysis it is revealed that only two factors are significantly effective on loyalty. The results of the analysis are summarized in Table 6.a-b.

**Table 6.a. Results of the Regression Analysis**

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | B | Std. Error | Beta | | | F | Sig. | R | $R^2$ |
| **1** | | | | | | 59,770 | ,000[a] | ,303[a] | ,092 |
| **(Constant)** | 2,328 | ,167 | | 13,969 | ,000 | | | | |
| **F4** | ,322 | ,042 | ,304 | 7,731 | ,000 | | | | |
| **2** | | | | | | 34,560 | ,000[b] | ,324[b] | ,105 |
| **(Constant)** | 2,593 | ,189 | | 13,744 | ,000 | | | | |
| **F4** | ,329 | ,041 | ,310 | 7,946 | ,000 | | | | |
| **F7** | -,085 | ,029 | -,114 | -2,930 | ,004 | | | | |

a. Predictors: (Constant), F4

b. Predictors: (Constant), F4, F7

**Table 6.b. Excluded Variables**

| Model | | Beta In | t | Sig. | Partial Correlation | Collinearity Statistics Tolerance |
|---|---|---|---|---|---|---|
| 1 | F1 | -,021 [a] | -,537 | ,591 | -,022 | ,983 |
| | F2 | ,024 [a] | ,574 | ,566 | ,024 | ,873 |
| | F3 | ,029 [a] | ,733 | ,464 | ,030 | ,979 |
| | F5 | ,048 [a] | 1,154 | ,249 | ,047 | ,903 |
| | F6 | -,059 [a] | -1,510 | ,132 | -,062 | ,992 |
| | F7 | -,114 [a] | -2,930 | ,004 | -,120 | ,996 |
| 2 | F1 | -,002 [b] | -,048 | ,962 | -,002 | ,955 |
| | F2 | ,061 [b] | 1,416 | ,157 | ,058 | ,811 |
| | F3 | ,043 [b] | 1,083 | ,279 | ,045 | ,966 |
| | F5 | ,058 [b] | 1,410 | ,159 | ,058 | ,897 |
| | F6 | -,031 [b] | -,773 | ,440 | -,032 | ,924 |

a Predictors in the Model: (Constant), F4
b Predictors in the Model: (Constant), F4, F7

According to the table above showing the results of the regression analysis, the regression function can be written as follows;

**Loyalty = 2,593 + 0.329 * F4 – 0,085 * F7**

In summary, it can be noted that "product quality and distribution (F4)" affects loyalty positively whereas "situational factors (F7)" has a significantly negative effect on loyalty.

# RESULTS AND DISCUSSION

When the mean values for loyalty is examined, it can be decided that the loyalty for gas station brands is on average. In other words, it is not possible to talk about a high or low level of loyalty when considering gas station brands.

The factor analysis results point out the fact that brand choice for gas station brands is affected by numerous factors. By the help of factor analysis, these factors are grouped in seven different factors named as "sales promotions", "service quality", "brand awareness", "product quality & distribution", "social responsibility", "additional service/support" and finally "situational factors". As can be seen from the names of the factors in today's marketing environment it is not possible to talk about only tangible products. Due to the changes in consumers' needs and wants, developments in technology and the dynamic nature of marketing, the importance of services has increased in recent years. Even if the company sells tangible product today's customers expect some level of services accompanying them. Also, in Turkey there is no price war in this sector. In other terms, price levels don't change much between brands. This forces them to find new criteria such as service, promotions etc. on which they can compete. Therefore it is not surprising that service quality, additional service/support are seen as the factors affecting customers' brand preferences for gas station brands. Besides, today's conscious customers who are paying attention to the environmental issues are also waiting for companies to give importance on social responsibility activities and to be respectful to the environment. This can even cause them to switch brands, in other words can affect their brand choices.

Looking at the loyalty part of the study it is seen that some important points come up. It is reasonable that "product quality & distribution factor" has a positive effect on loyalty. Because of the product type the influence of product quality is higher in this sector. The quality of the product directly affects the life, performance and the sake of the car. This reason can cause customers to pay more attention to the quality of the product and when they find the brand they consider as high quality they don't want to switch the brand thus becoming loyal to it.

The second factor named as "situational factors" has a negative effect on brand loyalty. This can be explained by the emotional and behavioral aspects of loyalty which was mentioned in literature review part of the study. It was noted that if a person is always buying the same brand because of convenience or necessity this can't be named as real loyalty. There should also be emotional attachments with the brand. When the items making up the situational factors are examined it is seen that the customers prefer the brand because of convenience or necessity. Thus, it is not reasonable to talk about real loyalty depending on only the behavioral aspects. These reasons can explain the negative effect of situational factors which are mostly represented by the behavioral aspects of loyalty.

Finally, a surprising result worth mentioning here is sales promotions didn't have a significant effect on loyalty. Companies in Turkey are spending huge amounts of money in loyalty programs and sales promotion activities in this sector. The main reason of this can be that these promotional activities aren't organized depending on the needs of the customers. One promotional activity that is attractive for one person can't be charming for the most of the people in the target market. Therefore while arranging the promotional activities and loyalty programs, the needs of the customers shouldn't be overlooked. Further studies may examine this issue in detail and the reasons why sales promotions don't affect loyalty can be discovered.

# REFERENCES


Aaker, D.A. (1991). *Managing Brand Equity: Capitalizing on The Value of A Brand Name*. NY. The Free Pres.

Bloemer, J.M. and Kasper, H. (1995). The Complex Relationship Between Consumer Satisfaction and Brand Loyalty. Journal of Economic Psychology. 16(2). Pp. 311-329.

Bruhn, M. and Grund, M.A. (2000). Theory, Development, and Implementation of National Customer Satisfaction Indices: The Swiss Index of Customer Satisfaction (SWICS). *Total Quality Management*, 11 (7), pp. 1017–1028.

Caceres, R.C. and Paparoidamis, N.G. (2007). Service Quality, Relationship Satisfaction, Trust, Commitment and Business-to-Business Loyalty. *European Journal of Marketing*. 41(7/8), pp. 836-867.

Chen, C.F. and Tsai, M.H. (2008). Perceived Value, Satisfaction and Loyalty of TV Travel Product Shopping: Involvement As A Moderator. *Tourism Management*. 29, pp. 1166-1171.

Dick, A.S. and Basu, K. (1994). Customer Loyalty: Towards an Integrated Framework. *Journal of Academy of Marketing Science*, 22(2), pp. 99-113.

Ehrenberg, A. (1988). *Repeat Buying Facts, Theory and Applications In Marketing*. Oxford University Pres, New York. NY.

Ehrenberg, A., Gerald, J. and Barwise, P.T. (1990). Double Jeopardy Revisited. *Journal of Marketing*, 54(3), pp. 82-91.

Gentry, L. and Kalliny, M. (2008). Consumer Loyalty-A Synthesis, Conceptual Framework, and Research Propositions. *The Journal of American Academy of Business*, Cambridge. 14(1), pp. 1-9.

Gounaris, S. and Stathakopoulos, V. (2004). Antecedents and Consequences of Brand Loyalty: An Emprical Study. *Journal of Brand Management*. 11(4), pp. 283-306.

Guest, L. (1994). A Study of Brand Loyalty. *Journal of Applied Psychology*. 28, pp. 16-27.

Javalgi, R. and Moberg, C. (1997). Service Loyalty: Implications For Service Providers'. *The Journal of Services Marketing.* 11, pp. 165-179.

Kim, J., Morris, J.D. and Swait, J. (2008). Antecedents of True Brand Loyalty. *Journal of Advertising*. 37(2), pp. 99-117.

Lau, G.T. and Lee, S.H. (1999). Consumers' Trust In A Brand and The Link To Brand Loyalty. *Journal of Market-Focused Management.* 4(4), pp. 341-370.

Meyer, T. (2008). Experience-based aspects of shopping attitudes: The roles of norms and loyalty. *Journal of Retailing and Consumer Services*. 15, pp. 324-333.

Nunnally, J. (1979). *Psychometric Theory*. New York: McGraw Hill.

Oliver, R.L. (1999). Whence Consumer Loyalty. *Journal of Marketing*. 63, pp. 33-44.

Punniyamorthy, M. and Raj, P.M. (2007). An Emprical Model for Brand Loyalty Measurement. *Journal of Targeting, Measurement and Analysis for Marketing*. 15, pp. 222-233.

Thiele, S. and Mackay M. (2001). A Brand For All Seasons? A Discussion of Brand Loyalty Approaches and Their Applicability For Different Markets. *Journal of Product and Brand Management*. 10(1), pp. 25-37.

# THE EFFECT OF WORD OF MOUTH COMMUNICATIONS ON CONSUMERS' PURCHASING DECISIONS: IN A GLOBALIZED WORLD A CASE STUDY FROM TURKEY

**Ruziye COP**
**Fatih SEN**
**Niyazi Gumus**
**Abant Izzet Baysal Univesity, Turkey**

## ABSTRACT

*Nowadays consumers tend to objective and independent information sources due to the message confusion caused by mass media, being many products that filled same needs in market, etc. Consumers get information from other consumers about the products before purchasing activity and they think that information obtained through word of mouth communications is more trustworthy than other sources. Word of Mouth Marketing is a reference to the passing of information from consumer to consumer. Originally the mouth referred specifically to oral communication. As a result of these interpersonal interactions, consumers conduct their purchasing decisions.*

*Although there are lots of word-of-mouth communication studies, arising in the marketing literatures in recent years as an important topic in the marketing, in marketing literature abroad, there is a lack of studies on word-of-mouth communication carried out in Turkey. Word of mouth communication is a type of communication occurring naturally without an effort, about products and services, which occurs between customers, and effects consumers' purchase decisions.*

## INTRODUCTION

The emergence of globalization, development of communication technologies, similarity between the goods and services manufactured and the continuously increasing competition increased the distance between the consumer and the enterprises. This brought together the efforts of enterprises to access the consumers. Enterprises, which are in the effort of reaching the consumers, force the consumers to purchase goods and services through various means of communication. As a consequence of this, the conflict of message created by mass communication means lead to the confusion in the minds of consumers due to presence of numerous products in the market that respond to the same need. This complicated environment directs the consumers towards objective and independent information resources in their purchasing decisions. This objective and independent information resource is the communication among consumers. Before performing the purchasing action, consumers receive information from other consumers around them and consider that this information, which they have received through word of mouth communication, is more reliable. Consumers direct their purchasing decisions as a result of these inter-personal interactions. Word of mouth communication is a way of interaction between consumers that takes place spontaneously about products and services, and is quite efficient. Consumers talk about their daily lives in any environment where they could communicate with each other. Studies carried out demonstrate that the issues they have spoken of are related to the goods and services they use, and that they transfer their positive/negative experiences to each other. Regardless of whether the enterprises accept this as part of marketing communication, they must focus on word of mouth communication between the consumers under the existing market conditions.

## CONCEPT OF WORD OF MOUTH COMMUNICATION

Word of mouth communication, which has been pronounced since 1950s, has important impacts on the attitudes, behaviors and purchasing decisions of consumers, and it has significant contributions in perception by the consumers of brands and their consciousness about goods and services. Word of mouth communication is defined as a form of non-commercial, face-to-face communication that takes place between the receiver and giver about a product or service (Arndt, 1967: 291). Characteristics of word of mouth communication involve value, focus, timing, demand and participation (Buttle, 1998: 245). Whereas the word of mouth communication may spontaneously commence between the consumers, it may also be launched by various information / communication resources. These resources are innovators, opinion leaders, market wolves, reference groups and other resources.

# PLACE OF WORD OF MOUTH COMMUNICATION IN PURCHASING DECISION PROCESS OF THE CONSUMER

According to the advertising experts, a consumer is exposed to sales communication from two hundred to one thousand a day taking into account the television ads, radio ads, newspaper, magazine ads, advertisement posters in buses, subways and buildings, billboards, tele-marketers, mail advertisements sent directly and tens of advertisements received through e-mail (Silverman, 2006: 40). Consumers do not look at and almost ignore all of these advertisements which they are exposed to. And they seek help from their friends, families about goods and services they would lie to purchase (Kelly, 2007: 16). For this reason, they are required to direct themselves towards new communication means.

# LITERATURE, METHOD AND FINDINGS

## Literature

Grewal et al. (2003: 187) demonstrated in the study they carried out on consumer behaviors that early entrance to market increased positive word of mouth communication about the brand, and that positive word of mouth communication positively affected the purchase of brand. Besides, it has been found that similarity between brands negatively impacted the purchasing decision of consumers. In the study of Davidow (2003: 67) of impact of word of mouth communication on re-purchasing decisions after processing of complaints and the perceived satisfaction, it is indicated that ignoring or not resolving the consumer complaints lead to negative word of mouth communication about goods and services. In the study it is indicated that consumers decided on purchasing again according to the responds given to complaints. Besides, it is emphasized that word of mouth communication positively affected the purchasing decision. In the study carried out by Duhan et al. (1997: 291) on impacts of word of mouth recommendations on consumers, it was determined that information gathered by consumers from various resources affected their word of mouth communication and that they applies word of mouth communication depending on whether the information they sought is valuable or what sort of an information it is. In the study carried out by Gelb and Johnson (1995:55) on the reasons and results of word of mouth communication, they emphasized that word of mouth communication was more impressive on purchasing decisions of consumers than advertisements, and that the word of mouth communication among consumers was more convincing compared to providing information. Mangold et al. (1999:83) emphasized in their articles on word of mouth communication in service market that in the service sector, consumers use negative word of mouth communication due to lack of information and that the enterprises should inform the consumers without any missing. According to the study, enterprises could ensure commencement of positive word of mouth communication by participating in and supporting various civil society events and engaging in social activities. It was emphasized that promotion activities should be regulated to launch positive word of mouth communication about their enterprises. East et al. (2008: 217) indicated in the study about measuring the impact of word of mouth communication in brand preference demonstrated that the purchasing decisions of consumers was affected more by positive word of mouth communication than negative word of mouth communication. . The study also expressed that the proximity of parties who use word of mouth communication and the expressions they use also determined the impact of word of mouth communication. In the study carried out by Walker (2001: 65) about consumer behaviors, it was stated that the party that starts the communication, rather than the receiver, is important in word of mouth communication. Walker states that the consumer should be satisfied from the goods and services he/she purchases in order to be a launcher of word of mouth communication and that high level of satisfaction provided by the goods and services could reverse even some negative opinions. In the study about dynamics of negative communication, Coombs and Holladay (2007: 310) indicated that consumers used negative word of mouth communication in cases where they are not satisfied from goods and services they use. The study emphasizes that consumers used negative word of mouth communication in case of legal violations by managers and of willful misconducts. Burke (1996: 225) indicates that enterprises should use the elements of promotion within the frame of a common message, that in order that the word of mouth communication be successful, this should be used together with other means of promotions under the control of the enterprise. In his study about the role of word of mouth advertising in retail sector, Bolen (1994: 13) emphasized that word of mouth communication is the most effective means of communication, that consumer complaints are very important opportunities for the enterprises in terms of launching positive word of mouth communication among consumers. In his work Bolen expresses special discounts, sales development efforts, kind and sincere behaviors of the staff are quite important for positive word of mouth communication. Anderson (1998: 16), in his work on consumer satisfaction and word of mouth communication, indicates that the levels of satisfaction /non-satisfaction from the goods and services they purchase are important in order to let them become launchers of word of mouth communication. It is also indicated that some consumers blemish the goods and services they use. Halstead (2002:10) indicated that consumers who are not satisfied from goods and services they use apply word of mouth communication more than those who are satisfied. Whereas it was stated that the level of satisfaction was important in launching the word of mouth communication, it was added that consumers applied word of mouth communication about abstract services more than they do about concrete goods. In a study about impact of word of mouth communication on assessing a brand, Sundaram and Webster (1999: 670) suggested that negative word of mouth communication is significantly important in assessing a brand, adding that negative assessments about the brand directed the consumers to purchase less from the products of that brand. Besides, the study expressed that negative word of mouth communication about the brand negatively impacted the reliability of the brand. In a study carried out on service sector, Babin et al. (2005: 133) stated that consumers were launchers of word of mouth communication after hedonic emotions and high satisfaction. Subject of word of mouth communication for services involve such issues as the coincidence of the environment in which the service is provided and the quality of service with the expectation of the consumer. It was indicated that negative word of mouth communication was more impressive on preference of services. Kim et al. (2001: 288) emphasized in their study about impacts of relational marketing on re-purchasing and word of mouth communication that managers of marketing department should work in collaboration with other departments in order that the word of mouth communication be successful, and that all departments should cooperate in order to increase customer confidence, elevate customer satisfaction and disseminate positive word of mouth communication.

## Method

Descriptive research model has been used in the research. The research was applied on 500 consumers living in Bolu and the results were analyzed through percentage analysis, factor analysis, variance analysis and Turkey test. The basic purpose of the study is to measure the impact of word of mouth communication on automobile purchasing decisions of consumers. Besides the study examines what the concept of word of mouth communication is, which factors it is connected to and among whom it takes place. Sub goals include;

- Level of being affected from information obtained from close environment,
- Level of being affected from means of communication,
- Level of being affected from the information environment
- Status of being the launcher of word of mouth communication
- Determining the attitudes and behaviors after purchasing
- Identifying from whom the consumers are affected the most in word of mouth communication

In this study, which analyzes the impact of word of mouth communication on automobile purchasing decisions, it was tried to identify the relationship between the demographic characteristics of consumers responding the questionnaire and their levels of requesting information from their vicinity, levels of being launcher of word of mouth communication after purchasing, levels of being affected by the means of communication, levels of being affected from the information environment and finally the attitude and behavioral factors following purchasing.

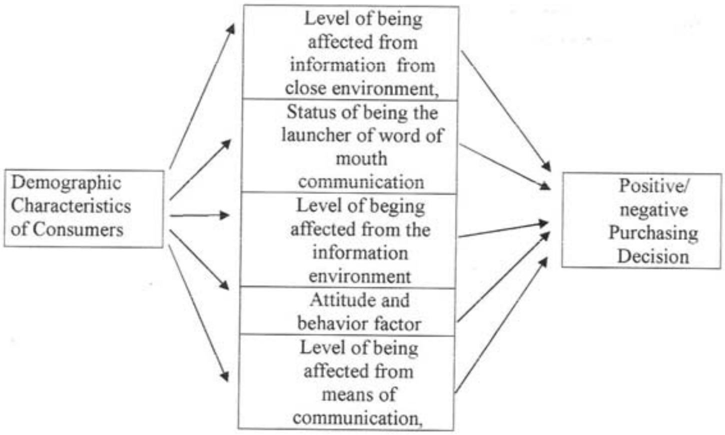



**Figure 1** Model for Word of Mouth Communication in Consumer's Purchasing Decision

# Findings

## Percentage Analysis

- According to the findings we have obtained, %95 of the responders indicated that they exchanged opinions with their environment before making a decision on purchasing an automobile. Number of people with whom they exchanged opinions was 3 – 6 people with %39,8, and a high majority of the consumers exchanged opinions with someone before making a decision on purchasing an automobile.
- As their reliable sources of information before purchasing an automobile, responders indicated their family members and relatives with a rate of %62,4 (among family and relatives, automobile services, friends, internet, television, comments in newspapers and magazines) Almost half of the responders seek advice from their environment before making a decision to purchase automobile.
- Responders mostly transfer their negative /positive assessments following a purchase. Another result that might contribute in the impact of word of mouth communication is the fact that the rate of consumers' mentioning to their vicinity about a product they newly purchased is %47,8.

## Factor Analysis

Survey results were subjected to the reliability test, and as a result of the test Cronbach Alpha was found as 0.87, and high values were found in KMO test, being 0.843, and Barlett test, being 0.000.

**Table 1. Factor distribution chart**

| | Factors | | | | |
|---|---|---|---|---|---|
| | **1** | **2** | **3** | **4** | **5** |
| | **,815** | ,098 | ,100 | -,004 | -,034 |
| | **,726** | ,303 | ,048 | ,069 | ,125 |
| | **,712** | ,053 | ,156 | ,141 | ,157 |
| **1. Factor** | **,702** | ,228 | ,075 | ,086 | ,044 |
| | **,700** | ,022 | ,101 | ,139 | ,116 |
| | **,674** | ,113 | ,003 | ,160 | ,084 |
| | ,056 | **,733** | ,024 | ,177 | -,075 |
| | ,226 | **,715** | -,039 | ,083 | ,071 |
| **2. Factor** | ,032 | **,701** | ,128 | ,302 | -,108 |
| | ,284 | **,592** | ,027 | -,028 | ,149 |
| | ,456 | **,551** | ,032 | -,046 | ,341 |
| | ,029 | **,418** | ,405 | ,194 | ,040 |
| | ,094 | **,391** | ,016 | ,228 | ,362 |
| **3. Factor** | ,088 | ,046 | **,866** | ,095 | ,043 |
| | ,118 | ,076 | **,832** | ,107 | ,019 |
| | ,232 | -,095 | **,613** | ,399 | ,051 |
| | ,147 | ,221 | ,089 | **,768** | ,108 |
| **4. Factor** | ,219 | ,166 | ,294 | **,670** | ,063 |
| | ,034 | ,223 | ,083 | **,597** | ,217 |
| | ,454 | ,012 | ,343 | **,509** | -,024 |
| | ,027 | -,168 | -,076 | ,187 | **,658** |
| **5. Factor** | ,168 | -,039 | -,155 | ,263 | **,645** |
| | ,079 | ,172 | ,313 | -,135 | **,611** |
| | ,137 | ,303 | ,203 | -,008 | **,525** |

## Factors and Questions Constituting the Factors

In the research, factors that impact the automobile purchasing decisions of consumers are as follows: *1. Factor: Level of being affected from information obtained from close environment; comprises of the following questions:* I believe that the information provided by consumers who previously used the same brand automobile is reliable. I believe that the information provided by my family and relatives about the automobile is reliable. I am impressed by the opinions of my family members and relatives while preferring the car brand. I am impressed by the opinions of my friends while preferring the car brand. I believe that the information provided by my friends about the automobile is reliable. I am impressed by the opinions of consumers who previously used the same brand while preferring the brand of automobile. *2. Factor: Status of being the launcher of word of mouth communication; comprises of the following questions:* When I am satisfied with the automobile I purchased, I express my satisfaction to where I purchased it from. When I am satisfied with the automobile I purchased, I write compliments about the brand I purchased on internet sites or forums. When I am satisfied with the automobile I purchased, I recommend that brand to people around me. When I am not satisfied with the automobile I purchased, I do not recommend that brand to people around me. When I am not satisfied with the automobile I purchased, I send my complaints to where I purchased it from. When I am not satisfied with the automobile I purchased, I write compliments about the brand I purchased, or the relevant firm, on internet sites or forums. When I am not satisfied with the automobile I purchased, I send my complaints to official authorities or consumer unions. *3. Factor: Level of being affected from means of communication; comprises of the following questions:* I am impressed from the researches I conduct on internet while preferring the automobile brand. While preferring an automobile brand, I am impressed from advertisements on the television, newspaper and magazines. I believe in the reliability of the information on internet. *4. Factor: Level of being affected from the information environment; comprises of the following questions:* I believe that the information provided by in newspapers and magazines about the automobile is reliable. I am impressed by the opinions of automobile dealers while preferring the car brand. I believe in the reliability of information provided by the automobile dealer while preferring the automobile brand. *5. Factor: Attitudes and Behaviors; comprises of the following questions:* When I am satisfied with the automobile I purchased, I recommend that brand when I am asked of it. When I am satisfied with the automobile I purchased, I try to convince people around me to buy that brand. When I am not satisfied with the automobile I purchased, I do not recommend that brand to people around me only if my opinion is asked. When I am not satisfied with the automobile I purchased, I try to convince people around me not to buy that brand.

As a result of the Turkey test carried out:

- When the relationship between the level of being affected from information obtained from close environment and the age characteristics of the responders is analyzed, it can be seen that people between 46 – 55 are affected from their close environment more than those between 36 – 45.
- When the relationship between being the launcher of word of mouth communication and the average incomes of responders is examined, it is found out that those having an income between 1000,00 TL – 1500,00 TL are launchers of word of mouth communication more than those with an income of 2000,00 TL and over and that they pay more attention on this.
- When the relationship between the level of being affected from the information environment and the age characteristics of responders is examined, differences among age groups are seen. Accordingly, those aged between 46 – 55 are more affected from the informing environment than the responders aged between 26 – 35.

## CONCLUSION AND RECOMMENDATIONS

Taking into account the stringent conditions of competition which the enterprises are exposed to and the distressed periods that the global economy undergoes, it is required in the business world to abandon the traditional methods in every field and to adopt strategic planning, implementation together with new methods and new approaches. The facts that advertisements started to gradually loose their impact despite the increasing costs that they fail to direct the consumer towards purchasing despite all investments made, that the enterprises produce products that are similar to each other put the enterprises in a difficult situation and confuse the minds of consumers. Consumers with confused minds take their decisions considering the evaluations of people who previously purchased that specific goods and services. Consequently, purchasing decisions of consumers are determined by their communication with other consumers rather than the promotional activities of enterprises. Therefore, enterprises and marketers are required to put more emphasis on the concept of word of mouth communications and to encourage the units which work on this issue.

- The point that should be focused on for automobile enterprises is the fact that consumers are affected by their family members and friends and that they make purchasing decisions in line with the recommendations of their family members. For this reason, enterprises should take into account the impact of family members and the environment and use this in their various advertising campaigns.
- Automobile enterprises should involve in the marketing process the consumers groups, which purchased or consider to purchase automobile, and thus let them impress other consumers through word of mouth communication. They should give their messages in relation to features of automobiles through this way.
- In order to enable the customers transfer their negative / positive assessments following a purchase to each other, automobile enterprises should design web sites accordingly, or prepare a separate web site for this purpose. In order to direct customer complaints to themselves and to resolve such complaints, enterprises should emphasize on efficient solution of complaints through free complaint hotlines or e-mails.
- Automobile enterprises should pay attention to create an environment in which the consumers could exchange opinions.
- Automobile enterprises should train their staff in order to impact the consumer decisions at the end sales point and to increase the relationship between sales staff and the consumer.

# REFERENCES


Anderson, W. Eugene. 1998.'Costumer Satisfaction and Word of Mouth', Journal of Service Research, Vol. 1, No. 1, 5-17.

Arndt, Johan. 1967. Role of Product-Related Conversationsin the Diffusion of a New Product, Journal of Marketing Research,Vol.4,No.3.Aug.

Babin, Bary J. Yong-Ki Lee, Eun Ju Kim, Mitch Griffin. 2005. 'Modeling Consumer Satisfaction And Word-of-Mouth: Restaurant Patronage in Korea', The Journal of Services Marketing; ABI/INFORM Global s. 133, 19, 3,

Bolen, William H. 1994. ' The Role of Word of Mouth Advertising in Retailing', American Business Review, May. 11-14.

Burke, Gerald Ian. 1996. 'Word of Mouth Communication: A Shared Cost Aproach' Journal of Marketing Communications, 2 219–230.

Buttle, Francis A. 1998,'Word-of-Mouth: Understanding and Managing Referral Marketing', Journal of Strategic Marketing, Vol. 6, 241-254.

Coombs, W. Timothy ve Sherry J. Holladay. 2007. 'The Negative Communication Dynamic' Journal of Communication Management, Vol.11, No.4, 300–312.

Davidow, Moshe. 2003. Have 'You Heard The Word ? The Effect of Word of Mouth on Perceived Justice, Satisfaction and Repurchase Intentions Following Complaint Handling' ,Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behavior;; 16, ABI/INFORM Global.

Duhan, Dale F ve Scott D. Johnson, James Wilcox, Gilbert Harrel1997. Influencer on Consumer Use of Word of Mouth Recommendation Sources' Academy of Marketing Science, Journal: ABI/INFORM Global, 293, Fall.

East, Robert ve Kathy Hammond, Wendy Lomax, 2008. 'Measuring The Impact of Positive and Negative Word of Mouth on Brand Purchase Probability', International of Journal Research in Marketing, 215-218.

Gelb, Betsy ve Madeline Johnson. 1995. 'Word-of-Mouth Communication: Causes and Consequences' Marketing Review Vol. 15. No :3Fall .

Grewal, Rajdeep, ve Thomas w. Cline, Anthony Davies. ,2003 'Early-Entrant Advantage, Word-of-Mouth Communication, Brand Similarity, and the Consumer Decision-Making Process', Journal of Consumer Psychology, 187-197,13 (3).

Halstead, Diane. 2002. 'Negative Word of Mouth: Substitute for or Supplement Consumer Complaints?', Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behavior; ABI/INFORM Global 1,15.

Kelly, Lois. 2007. Beyond Buzz: The Next Generation of Word of Mouth Marketing, New York: AMACOM.

Kim, Woo Gon, Jin Soo Han, Euehun Lee, 2001. 'Effects of Relationship Marketing On Repeat Purchase And Word Of Mouth', Journal of Hospitality & Tourism Research, Vol. 25, No. 3, August, 272-288.

Mangold, W. Glynn, F. Miller, G.R. Brockway 1999. "Word-of-Mouth Communication in The Service Marketplace", Journal of Services Marketing, Vol.13, No. 1, 73–89.

Lam, Desmond ve Dick Mizerski 2005. 'The Effects of Locus of Control on Word of Mouth Marketing', Journal of Marketing Communications' Vol.11, No. 3 215-228.

Odabaşi, Yavuz ve Gulfidan Barış. 2007.Tuketici Davranisi, Istanbul: MediCat Yayinlari.

Rogers, M.Everett, 1995.Diffusion of Innovations. USA:Free Pres.

Rosen, Emanuel, 2000.The Anatomy of Buzz, New York:Doubleday.

Silverman, George. 2006.Ağızdan Ağıza Pazarlama: WOM' un 28 Sırrı. (Çev:Ender Orfanlı).Istanbul: MediCat Yayinlari.

Solomon, Michael R. ve Elnora W. Stuart. 2000.Marketing: Real People, Real Choices. 2th Edition, USA :Prentice Hall.

Sundaram, D.S.ve Cytithia Webster. 1999. 'The Role of Brand Familiarity on the Impact of Word-of-Mouth Communication on Brand Evaluations', Advances in Consumer Research Volume 26, 664-674.

Walker, J. Jean Harrison, 2001. 'The Measurement of Word of Mouth Communication and Investigation of Service Quality and Costumer Commitment as Potential Antecedents'' Journal of Service Research, Vol. 4, No. 1, 60-75, August.

# SOCIAL RESPONSIBILITY PROJECTS OF THE SERVICE FIRMS WHICH ARE TRADED IN ISTANBUL STOCK EXCHANGE'S (ISE) SERVICES INDEX

**Nilsun SARIYER**
**Serhat HARMAN**
**Ebru KANYILMAZ POLAT**
**Çanakkale Onsekiz Mart University, TURKEY**

## ABSTRACT

*Corporate social responsibility (CSR) concept has contained that organizations give something back to the society. Especially firms in the service sector focus on social responsibility project. This research tries to examine social responsibility project and project areas of the service firms which are traded in ISE. For this purpose, annual reports of 28 service firms were content analyzed. According to the findings, 719 activities or projects accepted as "Social Responsibility" are held by service firms. Finally, firms have social responsibility project. And this project generally education and health area.*

***Keywords:*** *Social Responsibility, Social Responsibility Project, Service Firms, İstanbul Stock Exchange.*

## INTRODUCTION

Creating good relationship between organization and society is very essential for future performance of organizations. Social responsibility projects are the activities carried out by businesses to help the society. Businesses consider these activities primarily as duty and secondarily investments for the future attempting this task of meeting differing requirements is based upon recognition of their own position in the community and the values upon which they are founded. This is mentioned as social responsibility of business or social responsibility of a company. These do not only mean profit for stockholders or company owners but also concern impact of decisions in business and each and every action of the company on all it may concern, inside and outside of the organization (Becker and Potter, 2002). According to the European Commission, "Companies voluntarily take actions to improve quality of life of their employees and to protect the environment" (Promoting a European Framework for Employment and Social Affairs, 2001; 6). They do it because they are becoming aware of the relation between responsible actions and success and stability in business (Bartkowiak, 2006; 133).

Actually it is difficult to explain the social responsibility of any particular business. There is no certain definition of this term. In addition the fact is that corporate social responsibility (CSR) is one of the most prominent concepts in the literature, it is still difficult to give a precise and commonly accepted definition. However, CSR has been characterized by academic world in last decades. Therefore CSR description differs among academics. We deal with this paper social responsibility definition, firstly. Based on the theoretical framework, we try to determine whether organizations give back something which called social responsibility project to the society. Then if organizations give back social responsibility to it, we will answer what the social responsibility projects are.

## LITERATURE REVIEW

CSR has moved from ideology to reality, and many consider it an absolute necessity that organizations define their roles in society and apply social, ethical, legal, and responsible standards to their businesses (Lichtenstein et al., 2004; 22; Lindgreen and Swaen; 2004; 354). CSR is reflected the social imperatives and the social consequences of business success (Matten and Moon, 2008; 405). Generally CSR is concerned with treating the stakeholders of the firm ethically or in a responsible manner (Hopkins, 2003;14). Also, CSR is an umbrella term overlapping with some, and being synonymous with other, conceptions of business-society relations (Matten and Crane 2005;168). The impact of CSR policies are carried out by a company on the behavior of consumer (Perini and Castaldo, 2008; 2). It is about the core behavior of companies and the responsibility for their total impact on the societies in which they operate (Marsden, 2001). CSR is actions that appear to further some social good, beyond the interests of the firm and that is required by law (McWilliams and Siegel 2001; 855). CSR can most simply be defined as a set of management practices that ensure the company to minimize the negative impacts of its operation on society while maximizing its positive impacts (Pinney; 2001). CSR is actions that appear to further some social good, beyond the interests of the firm and that is required by law (McWilliams and Siegel 2001; 855). The notion of CSR is based on an organizational effort to take responsibility for a particular perceived need or correction in a stakeholder relationship (Kleinrichert, 2007;476). But corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract, indicating that a stake may go beyond mere ownership (Jones, 1980, 60). It is accepted that a corporation generally has four classes of responsibilities, which are economic, legal, ethical and discretionary responsibilities. Economic responsibilities refer to making profit for owners and shareholders producing goods and service. These will satisfy needs and wants of the society, legal responsibilities of corporate means the activities which must be done according to the legal regulations. The ethical responsibilities of corporate refers that the activities depend on the society's belief and value systems. The last class of responsibility is the ones which are optional by the decisions of owners and the shareholders (Wheelen and Hunger, 2004; Carroll, 1979). CSR implies bringing corporate behavior up to a level where it is congruent with the prevailing social norms, values, and expectations'' (Sethi, 1975; 62). CSR is defined as activities that ''protect and improve both the welfare of society as a whole and the interest of the organization'' (Davis and Blomstrom, 1975; 5). Corporate responsibility is the notion that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract (Jones, 1980; 59). Corporate citizenship is concerned with the relationship between companies and society – both the local community, which surrounds a business and whose members interact with its employees, and the wider and increasingly worldwide community, which touches every business through its products, supply chain, dealer network, and its advertising, among other things'' (McIntosh et al., 1998; 20). Good corporate citizenship can be defined as understanding and managing a company's wider influences on society for the benefit of the company and society as a whole'' (Marsden and Andriof, 1998; 350; Andriof and Marsden, 2000; 2). According to the World Business Council for Sustainable Development, ''Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large'' (Holmes and Watts, 1999; Chand, 2006; 240).

The idea of social responsibility of business is connected with three themes: internal environment of business organizations, direct environment of the organization and total social context (Crowther, 2002; 27). Accordingly, enterprises have noted that social responsibility is good for business for, and from, each part of the seven main azimuths within which they trade and operate. These parts are their shareholders and potential investors, managers, employees, customers, business partners and contractors or suppliers, the natural environment, and the communities within which they operate, including national governments. These are now commonly known as the firm's stakeholders (Hopkins, 2003; 49). Organizations have to take on `social responsibility`. There is no one else in the society of organizations to take care of society itself. Yet, organizations must do so responsibly, within the limits of their competence, and without endangering their performance capacity (Drucker, 1993; 47). Clearly local cultures affect how consumers expect companies to behave, as does the response from and type of product sold by a company in a given country. Sometimes, culture and economics combine to produce different products. For instance, for many years visitors from Europe to the US were astonished at the size of their cars compared with their European equivalent. A wide, open country and cheap oil contributed to this, as did higher taxes on oil and the more confined space to which Europeans were accustomed. However, some convergence can be seen as the environmental lobby presses for less gas-guzzling cars and congestion increases. In fact, the astonishing convergence in the look of cars today across countries compared with a decade or so ago attests to the rapid convergence of tastes and culture- the strange-looking Citroën Deux Chevaux or the Trabant are now, unromantically, confined to the past. In a similar way, the interpretation of social responsibility differs from country to country. The US is one of the leaders in applying corporate responsibility standards to its companies (but less so corporate social responsibility) as this is increasingly accompanied by a variety of awards being given for good practice. However, the gap between "application" and "observance" seems not to have closed as fast as it might appear from the outside. Enron's receipt of several awards in the environmental area did not overflow into the area of corporate governance, ethical behavior or financial probity. The UK also seems to have gone a fair way along the CSR path. There, as a result of the Thatcher revolution, business has been given prominence over the public sector for the first time since the 19th century. A plethora of institutions and networks have arisen to monitor and comment upon the ethical and social responsibility of business (Hopkins, 2003; 122).

# METHODS

This research was to come up with a concise framework by which to assess the corporate social responsibility of a group of services sector in Turkey. This sector is particularly selected. Because service can be defined as, diametrically opposed non-material counter piece of a physical good. A service provision comprises a sequence of activities that does not result in ownership of the outcome, and this is what fundamentally differentiates it from furnishing someone with physical goods. Provision of service is a process that creates predetermined benefits by effectuating either a change of service consumers, a change in their physical possessions or a change in their intangible assets (Petit; 1987). According to the US Coalition of Service Industries (2007), in the US 90 % of all new jobs added between now and 2012 will be service-oriented. And because of rapidly changing environment and high level of competition managers will be seeking increasingly ingrained ways to differentiate service offerings to provide value to consumers. Social responsibility projects and activities might be a good way to differentiate the service firm both in the eyes of costumers and investor and other stakeholders as well. Considering, we derive several research questions to guide our study.

- What current CSR practices exist?
- What do organizations prefer CSR?

Content analysis is used in this research. According to Ruf et al. (1998), content method has an objective rating of companies since once the social attributes are selected, the process of rating is standardized (121). However, the information given in a corporate report can be different from the actual corporate actions (McGuire et al.,1988). Companies may mislead the potential readers of these reports in order to create a more favorable image. Therefore, the reliability of company reports may represent a significant limitation. Previous studies that focus on the reliability of corporate environmental disclosures have provided empirical evidence that there is no significant association between the content of these reports and actual performance (Freedman and Wasley, 1990; Ingram and Frazier, 1980; Rockness,1985; Wiseman, 1982). Ironically, poor performers provided longer environmental disclosures (Ingram and Frazier, 1980). The research is preferred annual reports that attested. Data was collected through annual reports of 36 service sector firms which are traded Istanbul Stock Exchange (İSE). It was found that only 28 of 36 announced their social responsibility projects. The data was selected from annual reports' "Social Responsibility" section. In the research, only annual report of 2007 was content analyzed. While the data collecting process (2009 February-March) annual reports of these firms for year 2008 have not been explained unfortunately.

# FINDINGS

Distribution of social responsibility projects according to the service index firms is listed in the Table 1. Findings shows that *Acıbadem Health Care Institution* has sponsored 3 sport teams, organized 337 meetings about public health, published 9 books and 5 health journals, distributed 238 scholarships, owned 1 foundation, contributed to 1 foundation and owned special university. *AFM Cinemas Inc*. has contributed to 3 foundations, played 10 movies publicly. *Ak Energy* has made contribution to 4 foundations, organized a meeting in the World Environment Day and built a joined project in cooperation Environmental NGO. *Aksu Energy* has owned a special forest. *Ayen Energy* has not announced any social responsibility activity in company's annual report.

*BİM Stores* and *Boyner Retailing Company* have declared they only have Waste Management System in their annual report's social responsibility section. *CarrefourSA* as mergered company has not had self-managed social responsibility project CarrefourSA has helped projects with the Sabanci Holding.
*Çelebi Ground Handling* has announced that there is a Waste Management System, there has been publicly film show and a seminar has been organized by Çelebi Ground Handling. *Doğuş Automobile Inc*. has sponsored 2 sport teams, organized 1 meeting contributed to 1 health project, 1 traffic project, owned 1 foundation and contributed to 1 foundation, owned 1 special forest, opened 11 art exhibitions and 1 concert, sponsored to 1 museum and a movie show and organized 2 festivals and opened a culture center.

*Enka Construction Company* has owned 1 foundation, 1 sport club, opened 1 school, sponsored to 1 concert and sponsored to 13 theater shows. *Intema* has organized 1 meeting, published 1 book, had Waste Management System, opened 1 school and developed 1 educational project. *Marmaris Altin Yunus Tourism Inc*. has announced that they have contributed 2 foundations. *Marti Hotel* did not announced any social responsibility projects.

On the other hand, *Migros Retailing Company* has sponsored 1 sport team and contributed to 12 foundations, they had special forest and in stores they 2 different Waste Management Systems. Migros has 1 sport club, has sponsored 11 theater shows, has developed 1 educational project and 1 environmental project, sponsored 14 festivals, they have organized 2 trips for poor people and cloth help, Migros also has opened 1 culture center. *Milpa, Net-Tur,* and *Sanko Marketing* has announced no social responsibility projects in their annual reports. *Reysaş Logistics Inc.* only contributed to 1 educational project.

*Şelçuk Pharmaceutical Warehouse* has built 1 mosque, contributed to 1 foundation and published 1 journal, sponsored 2 sport clubs, they have culture center and repaired 1 school, and they have developed social project for street children. *Tek-Art Tourism Company* has sponsored 2 sport teams and they have Waste Management System.

*Tesco-Kipa* has contributed to 1 foundation and distributed scholarship to 4000 students, have Waste Management System, and organized 6 conference. *Turkcell* has organized 1 competition, and sponsored 3 sport teams, and has developed 2 educational projects and opened 3 culture centers, and organized 1 trade fair. *Turkish Airlines* has developed projects for Disabled people and distributed 42 scholarships and made contribution to Turkish Red Crescent Society.

*Turk Telekom* has special forest, opened 55 schools, sponsored to 1 festival, has opened 1 museum and 2 culture centrers, and sponsored 47 sport teams. *Usaş Airport Catering* has contributed to 1 foundation. *Vakko Textiles* has Waste Management System. *Zorlu Energy* has 1 foundation, made contribution to 2 foundations and They have declared that they have Waste Management System.

In the Table 2, number of each type of activity is presented. According to that distribution in the year 2007 in 719 social responsibility projects was implemented by ISE service index firms. Meeting sponsorships are mostly held (345) but most of these meetings (337) were held by Acıbadem Health Care Institution. Second highly preferred project type is Team Sponsorship (59). Then it is followed by school building (57). It is understood that distributing scholarship (44) is also popular among the İSE service index firms. Eight of the firms see Waste Management System as social responsibility project. In addition we can say that they are interested in social issues (educational, environmental and traffic projects).

# Table 1. Distribution of Social Responsibility Projects According To the Firms

| Name Of Company \ Type Of Project | Foundation | Contribution to Foundation | Book Publishing | Journal Publishing | Scholarship | Movie Show | Special Forest | Waste Management | Exhibition | Museum | Festival Sponsorship | Concert Sponsorship | Theater | Educational Project | Environmental Project | Traffic Project | Cloth Aid | Trip | Building School | Culture Center | Team Sponsorship | Sport Club Owning | Seminar | Meeting Sponsorship | Fair | Projects For Disabled People |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ACIBADEM HEALTH | 1 | 1 | 9 | 5 | | | | | | | | | | | | | | | | | 3 | | | 337 | | |
| AFM FİLM | 3 | | | | | 10 | | | | | | | | | | | | | | | | | | | | |
| AK ENERGY | | 4 | | | | | | | | | | | | | 3 | | | | | | | | | | | |
| AKSU ENERGY | | | | | | | 1 | | | | | | | | | | | | | | | | | | | |
| AYEN ENERGY | | | | | | | | | | | | | | | | | | | | | | | | | | |
| BİM STORES | | | | | | | | 1 | | | | | | | | | | | | | | | | | | |
| BOYNER REATILING | | | | | | | | 1 | | | | | | | | | | | | | | | | | | |
| CARREFOURSA | | | | | | | | | | | | | | | | | | | | | | | | | | |
| ÇELEBİ GROUND HANDLING | | | | | | | 1 | 1 | | | | | | | | | | | | | | | 1 | | | |
| DOĞUŞ AUTO | 1 | 1 | | | 1 | 1 | | | 11 | 1 | 2 | 1 | | | | 1 | | | | 1 | 2 | | | 1 | | |
| ENKACONSTRUCTION | 1 | | | | | | | | | | | 1 | 13 | | | | | | 1 | | | 1 | | | | |
| İNTEMA | | | 1 | | | | | 1 | | | | | | 1 | | | | | 1 | | | | | 1 | | |
| MARMARİS ALTINYUNUS | | 2 | | | | | | | | | | | | | | | | | | | | | | | | |
| MARTI HOTEL | | | | | | | | | | | | | | | | | | | | | | | | | | |
| MİGROS | | 12 | | | | | 1 | 2 | | | 14 | | 11 | 1 | 1 | | 1 | 2 | | | 1 | 1 | | | | |
| MİLPA | | | | | | | | | | | | | | | | | | | | | | | | | | |
| NET TURİZM | | | | | | | | | | | | | | | | | | | | | | | | | | |
| REYSAŞ LOGISTICS | | | | | | | | | | | | | | | | | | | | | | | | | | |
| SANKO MARKETİNG | | | | | | | | | | | | | | | | | | | | | | | | | | |
| SELÇUK PHAR.WARE. | | 1 | | 1 | | | | | | | | | | | | | | | | | 1 | 2 | | | | |
| TEK-ART TOURSIM | | | | | | | | | | | | | | | | | | | | | 2 | | | | | |
| TESCO KİPA | | 1 | | | 1 | | | 1 | | | | | | 1 | | | | | | | | | | 6 | | |
| TURKCELL | | | | | | | | | | | | | | 2 | | | | | | 3 | 3 | | | | 1 | |
| TÜRK AIRLINES | | | | | 42 | | | | | | | | | | | | | | | | | | | | | 1 |
| TURK TELEKOM | | | | | | | 1 | | | 1 | 1 | | | | | | | | 55 | 2 | 47 | | | | | |
| USAŞ | | 1 | | | | | | | | | | | | | | | | | | | | | | | | |
| VAKKO TEXTİLES | | | | | | | | 1 | | | | | | | | | | | | | | | | | | |
| ZORLU ENERGY | 1 | 2 | | | | | | 1 | | | | | | | | | | | | | | | | | | |

## Table 2. Types of Social Responsibility Projects

| Type of Activity | Frequency |
|---|---|
| Foundation | 7 |
| Contribution to Foundation | 25 |
| Book Publishing | 10 |
| Journal Publishing | 6 |
| Scholarship | 44 |
| Movie Show | 11 |
| Special Forest | 4 |
| Waste Management | 9 |
| Art Exhibition | 11 |
| Museum | 2 |
| Festival Sponsorship | 17 |
| Concert Sponsorship | 2 |
| Theater Sponsorship | 24 |
| Educational Project | 5 |
| Environmental Project | 4 |
| Traffic Project | 1 |
| Clothes Aid | 1 |
| Trip Organization | 2 |
| Building School | 57 |
| Culture Center | 6 |
| Team Sponsorship | 59 |
| Sport Club Owning | 4 |
| Seminar | 1 |
| Meeting Sponsorship | 345 |
| Fair | 1 |
| Projects For Disabled People | 1 |
| **TOTAL NUMBER of PROJECTS** | **719** |

# CONCLUSIONS AND DISCUSSION

In this paper, it was tried to examine social responsibility project and project areas of the service firms which are traded in ISE. Also, annual reports of 28 firms were content analyzed. Our findings indicate that 719 activities or projects which can be accepted as “Social Responsibility” were held by service firms operated in ISE in the year 2007. So, it could be said that service firms are sensitive about social needs of the society. The findings also indicate that widely preferred social responsibility areas are ordinarily; meeting sponsorship, sport team sponsorship, building schools, also, findings also indicate that, service firms are interested in artistic social responsibility projects or activities, if we check the bank which has the most number of projects or activities, we will see that Acibadem health care company has the largest number of projects or activities.

If we compare this study's findings with ISE Bank sample (Sarıyer and Harman, 2008), they have that widely preferred social responsibility areas are ordinarily; book publishing, congresses and meeting sponsorship, display and theater sponsorship, concert sponsorship, sport team sponsorship, educational projects, contributions, nature environment projects, art projects, archeological digs, documentary production, projects disabled people and scholarships. In the service firms sample it is found meeting sponsorship is most common activity then it is followed by team sponsorship. In the bank sample there are 16 different areas of social responsibility activities, here we have found 26 different areas of social responsibility activities. That comparison shows that service firms do their social responsibility activities with wide range of areas. For example, creating special forests, owning a foundation, waste management systems, sport club owning, culture center, trip organizations are different areas that service firms do their social responsibility activities. Scholtens (2009) have found more than 30 institutions and find significant differences among individual banks, countries, and regions. Furthermore, it appears that social responsibility of these banks has significantly improved between 2000 and 2005. (175) Another comparison could be made with textile sectore firms operating in Kahraman Maraş (Turkey) (Aybar , 2008). In this firm, health and educational projects are mostly preferred. But by ISE service firms meetings and sport oriented social responsibility projects are more common, this can be explained as by the size of firms in our sample (Akyar, 2008: 50). In another study, Arçelik's (the firm which is operating in white goods sector) social responsibility projects have studied. Arçelik's projects are focusing envirement protection. The firm have given training about environment (5244 hours), join an environment conference and support an environment NGO (TEMA). The firm also leaded to bring an importatnt exhibition to Turkey, and is sponsore of the Turkisch Basketball League the period of 2006-2010 (Berker, 2008; 108-115). Bay (2006) has conducted an empirical research on social responsibility projects of 1023 firms he has found that largely preferred social responsibility activity is to give aids to employees then it is followed by contribution to foundations, distributing scholarships to students and health projects.

Also, there is another major finding that some of the service firms do not announce their social responsibility activities in their annual reports or they do not do any social responsibility activities. For example, in the annual reports of Ayen Energy, Milpa, Marti Hotel, Net Turizm etc. there was no section called "Social Responsibility" or there was no activity listed in the annual reports' social responsibility section.
These findings can not be generalised. Because they reflect 28 service firms traded ISE. But these limitations should be considered when interpreting our results, but despite them, we believe our study offers several important contributions. First, the organizations' have current CSR policies and practices. Second, generally these organizations' give support to health and educational social projects. Differ studies may conclude different results. Since this research show social responsibility between theorical and application area.

## REFERENCES


Andriof, J. and C. Marsden (2000), Corporate Citizenship:What is it and How to Assess It?', to M. McIntosh and A. Warhurst (eds.), Third Annual Warwick Corporate Citizenship Unit Conference ,University of Warwick, Coventry.

Aybar, Halil (2008), İşletmelerde Sosyal Sorumluluk Üzerine Bir Alan Çalışması" Kahramanmaraş Sütçü İmam Üniversitesi Sosyal Bilimler Enstitüsü Yayınlanmamış Yüksek Lisans Tezi, Kahramanmaraş Turkey.

Bartkowiak, Grazyna (2006), Practical Aspect of a Social Responsibility in Business Opinion of Polish and French Managerial Staff and Employees about The Role of Social Responsibility of a Company, *Dialogue and Universalizm.* 5-6, pp.133-140.

Bay, Eyüp (2006), İsteğe Bağlı Sosyal Sorumluluk Bileşeninin Türkiye Kapsamında İncelenmesi, İstanbul Teknik University, İşletme Mühendisliği Bölümü, Basılmamış Yüksek Lisans Tezi , İstanbul, Turkey.

Becker, Edmund R. and Potter, Sharyn J. (2002), Organizational Rationality, Performance, And Social Responsibility: Results From The Hospital Industry, *Journal of Health Care Finance*, 29(1), pp. 23-48

Carroll Archie B. (1979), A Three-Dimensional Conceptual Model of Corporate Performance *Academy of Management Review,* 4 (4), pp. 497-505.

Chand, M.(2006), The Relationship Between Corporate Social Performance and Corporate Financial Performance: Industry Type as a Boundary Condition, *The Business Review*, 5(1), pp. 240–245.

Davis, K. and R. L. Blomstrom (1975), *Business and Society: Environment and Responsibility*, McGraw-Hill, New York.

Crowther, D (2002); A Social Critique of Corporate Reporting; Aldershot; Ashgate.

Drucker, Peter (1993), *Post-capitalist Society*, New York: Harper& Row.

Freedman, M. and C. Wasley (1990), The Association Between Environmental Performance and Environmental Disclosure in Annual Reports and 10-Ks, *Advances in Public Interest Accounting*, 3, pp. 183–193.

Holmes, L. and R. Watts (1999), Making Good Business Sense', in The World Business Council for Sustainable Development, Conches-Geneva.

Hopkins, Michael (2003), *Planetary Bargain: Corporate Social Responsibility Matters.* London:GBR: Earthscan Publications, Limited.

Ingram, R. and K. Frazier (1980), 'Environmental Performance and Corporate Disclosure', *Journal of Accounting Research*, 18(2), pp. 614–622.

Jones T.M. (2001), Corporate Social Responsibility Revisited, Redefined. *California Management Review*, 22(2), pp.59-67.

Khoury G., J. Rostami and J.P. Turnbull (1999), Corparate Social Responsibility:Turning Words into Action. *Conference Board of Canada*: Ottowa.

Kleinrichert, D. (2008), Ethics, Power and Communities: Corporate Social Responsibility Revisites, *Journal of Business Ethics*, 78, pp.475-485.

Lichtenstein, D. R., M. E. Drumwright and B. M. Braig (2004), The Effect of Corporate Social Responsibility on Customer Donations to Corporate-Supported Nonprofits, *Journal of Marketing*, 68(4), pp. 16-32.

Lindgreen, A. and V. Swaen (2004), Corporate Citizenship:Let not Relationship Marketing Escape the Management Toolbox, *Corporate Reputation Review* 7(4), pp. 346–363.

Lindgreen, A., Swaen v. and Johnston W. J. (2009), Corporate Social Responsibility:An Empirical Investigation of U.S. Organizations, *Journal of Business Ethics*, 85, pp.303–323.

Marsden C. (2001), The Role of Public Autorities in Corporate Social Responsibility. http://www.alter.be/social responsibility Access Date: 12.03.2008

Marsden, C. and J. Andriof (1998), 'Towards an Understanding of Corporate Citizenship and How to Influence

It', *Citizenship Studies*, 2(2), pp.329–352.

Matten, D. and J. Moon (2008), "Implicit and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility, *Academy of Management Review*, 33(3), pp.404-424.

Matten, D., A. Crane and W. Chapple (2003), Behind the Mask: Revealing the True Face of Corporate Citizenship', *Journal of Business Ethics* 45(1/2), pp. 109–120.

McGuire, J. B., A. Sundgren and T. Schneeweis (1988), Corporate Social Responsibility and Firm Financial

Performance, *Academy of Management Journal* ,31(4), pp. 854–872.

McIntosh, M., D. Leipziger, K. Jones and G. Coleman (1998), *Corporate Citizenship: Successful Strategies for Responsible Companies*, Pitman Publishing, London.

McWilliams A. and D. Siegel (2001), Corporate Social Responsibility:A Theory of The Firm Perpective. *The Academy of Management Review*, 22(4), pp. 853-886.

Murphy, Ruth and David Crowther (2002), Social Responsibility and Marketing: An Agenda for Research, *Management Decision*. 40 (4), pp. 302-309 to Crowther, David (Editor) (2002), *Social responsibility and marketing.* UK: Emerald Group Publishing Limited.

Nalbant, Z. E. (2000). İşletmelerde Sosyal Sorumluluk ve İş Ahlakı, *Celal Bayar Üniversitesi İ.İ.B.F. Dergisi,* 12(1), pp. 193-201.

Pascal Petit (1987). "Services," *The New Palgrave: A Dictionary of Economics*, The Macmillan Press Limited.

Perini, F. and S. Castaldo (January 2008), Editorial Introduction: Corporate Social Responsibility and Trust, *Buiness Ethics: A European Review*, 17(1), pp.1-2.

Pinney C. (2001), Imagine Speaks Out.How to Manage Corporate Social Responsibiliity and Reputation in a Global Marketplace to Dahlrud A. (2008), How Corporate Social Responsibility is Defined: an Analysis of 37 Definitions. *Corporate Social Responsibility and Environmental Management.* 15 (1-13), p.9.

Promoting a European Framework for Employment and Social Affairs (2001), *Green Paper Directorate General for Employment and Social Affairs -European Commission*, Brussels.

Rockness, J. W.(1985), An Assessment of the Relationship Between US Corporate Environmental Performance

and Disclosure', *Journal of Business Finance & Accounting*,12(3), pp. 339–354.

Ruf, B. M., K. Muralidhar and K. Paul (1998),The Development of a Systematic, Aggregate Measure of

Corporate Social Performance, *Journal of Management,* 24(1), pp. 119–133.

Sarıyer, N. and Harman, S. (2008). Social Responsibility Projects of Banks Which are Traded in Istanbul Stock Excahnge (ISE) Banking Index" Proceedings of 5. International Symposium on Business Administration, 5-8 May 2008, Çanakkale, Turkey, PP.95-100.

Scholtens, Bert (2009), Corporate Social Responsibility in the International Banking Industry, *Journal of Business Ethics* 86, pp.159–175

Sethi, S. P. (1975), Dimensions of Corporate Social Performance: An Analytical Framework', *California Management Review* 17(3), pp. 58–64.

Turker, D. (2009), Measuring Corporate Social Responsibility:

A Scale Development, *Journal of Business Ethics* 85, pp. 411–427

Wheelen, T.L and Hunger, J. D. (2004). *Strategic Management*, (5.pub.). Addison-Wesley Publishing Company, USA.

20. US Coalition of Service Industries (2007). Services drive growth. Retrieved from http://www.uscsi.org/about/

http://www.acibadem.com.tr/FinansalVeriler/2007_Financial_Results.pdf (Date: 04.04.2009)

http://www.afm.com.tr/Creator/SiteContent/Files/FaaliyetRaporu2007.pdf (Date: 04.04.2009)

http://www.akenerji.com.tr/_UserFiles/File/FaaliyetRaporlari/faaliyet_raporu_2007.pdf(Date: 04.04.2009)

http://www.www.ayen.com.tr/faaliyet_raporlari/faaliyet_raporlari.asp (Date: 04.04.2009)

http://www.yasar.com.tr/yasar_yatirimci/uploads/File/dosya_6_Ayces2007.pdf(Date: 04.04.2009)

http://www.bjk.com.tr/tr/medya.php?rn=19872&tipi=B(Date: 04.04.2009)

http://www.www.bim.com.tr/raporlar/faaliyet_Raporu_2007.pdf(Date: 04.04.2009)

http://www.boyner.com.tr/yatirim_pdf/boynefinansr.pdf(Date: 04.04.2009)

http://kurumsal.carrefour.com.tr/pdf/FaaliyetRaporu.rar(Date: 04.04.2009)

http://www.celebi.com.tr/pdf/sayi17/04_sosyalsorumluluk.pdf (Date: 04.04.2009)

http://www.dogusotomotiv.com.tr/assets/yatirimci_iliskileri/TR/01doastr2007.pdf (Date: 04.04.2009)

http://www.enka.com/tr-TR/pdf/FaaliyetRaporu2007.pdf (Date: 04.04.2009)

http://www.galatasaray.org/files/sportif/fraporu/gssportif-fraporu2007.pdf (Date: 04.04.2009)

http://www.intema.com.tr/assets/investorrelation/pi_filename1_33.pdf (Date: 04.04.2009) http://www.mares.com.tr/yatirim/2007tr.pdf (Date: 04.04.2009)

http://www.marti.com.tr/uploads/belgebankasi/2007_Donem_Faaliyet_Raporu.pdf (Date: 04.04.2009)

http://www.migros.com.tr/download/faaliyet_raporu/FaaliyetRaporu2007.pdf (Date: 04.04.2009)

http://www.www.milpa.com.tr/docs/kurumsal_tr/yatirimci/faaliyet2007.pdf (Date: 04.04.2009)

http://www.netholding.com/faaliyetrap.asp (Date: 04.04.2009)

http://www.sanko.com.tr/frapor/pdf/2008/faaliyetraporu.pdf (Date: 04.04.2009)

http://www.reysas.com/pdf/REYSAS-Faaliyet%20raporu%202007.pdf (Date: 04.04.2009)

http://www.selcukecza.com.tr/docs/faaliyet_raporu2007.pdf (Date: 04.04.2009)

http://www.tesco.kipa.com.tr/PDF/FaaliyetRaporlari/2007.pdf (Date: 04.04.2009)

http://www..clubzigana.com/Files/File/Faaliyet%20Raporu%202005.pdf (Date: 04.04.2009)

http://www.turkcell.com.tr/raporlar/faaliyet_raporu2007.pdf (Date: 04.04.2009)

http://84.44.113.3/download/2007_Faaliyet_Raporu.pdf (Date: 04.04.2009)

http//www.turktelekom.com.tr/telekom/tr/pdf/mali_operasyonel/2007_Finansal_Tablolar.pdf (Date: 04.04.2009)

http://webservice.foreks.com/chart/vakko/doc/FAALIYET%20RAPORU%202007.pdf (Date: 04.04.2009)

http://www.zorlu.com.tr/TR//zor_toplum.asp (Date: 04.04.2009)

# *INTERNATIONAL INTEGRATION & FOREIGN DIRECT INVESTMENT*

# CHINA-AFRICA COOPERATION IN THE 21ST CENTURY: ANALYSIS OF THE OBSTACLES AND CHALLENGES TO GOOD COOPERATION

**Kieran E. Uchehara,**
**Atılım University, Turkey**

## ABSTRACT

*The main object of this paper is to evaluate China-Africa cooperation in the 21st century. This engagement cannot be ignored for a variety of reasons. Firstly, it gives Africa leverage in its relations with the North. Secondly, China's emergence onto the global stage compels African government and their counterparts in the South to reflect on and adopt initiatives that address the challenges of globalization. Thirdly, for African policy-makers, a more nuanced understanding regarding the varied impacts that China can have on their economies and on Africa's development path is needed. For pessimists China represents a terrifying threat while for optimists it is a tantalizing opportunity. The key question is whether China's engagements in Africa are purely extractive or have a developmental impact. The paper looks in some detail at these real and possible impacts. It concludes that there are complexity of interactions between Chinese and African trade, investment and aid.*

***Keywords:*** *China, Africa, Partnership, Cooperation, Trade, Investment, Aid, Obstacles and Challenges*

## INTRODUCTION

The paper is motivated by the observations that the rapid and sustained expansion of the giant economy of China has been associated with a robust and increasing intensification of its economic relations with various African countries. And that these relationships are, in turn, associated with both opportunities and challenges for African countries. The primary purpose of this paper is to undertake a comprehensive review of literature on the impacts of China on African countries. This paper focuses on trade, investment and aid flows as the key channels through which the impacts of China may be transmitted to an African economy. The question that needs to be addressed then is have the Chinese Cooperation ventures contributed to driving new forces, generating positive spin-off, and serving as effective leapfrogging vehicles for Africa's development in the 21st century? Finally, the paper is based on discourse and literature review of the impact of China on Africa with special emphasis on trade, investment and aid.

## LITERATURE REVIEW

It needs to be underlined at the outset that the establishment of modern China-African relations goes back to 1961. Following Chairman Mao's observation that "We don't have a clear understanding of African history, geography, and the present situation" (Anshan, 2005: 1). From 1963-1964, Prime Minister of the Peoples' Republic of China Zhou Enlai made a ten country visit to Africa. The general aim of Premier Chou Enlai's visit to Africa were to: 1) underscore the implementation of the One-China policy and foreclose Taiwan's diplomatic relations with Africa, 2) respect the principles of sovereignty and non-intervention, 3) promote development on the basis of equality and mutual benefit, 4) seek prestige by presenting itself as mentor or a de facto leader or a moral leader of the developing world in the United Nations, and 5) de-link the progressive African nations from the hegemonic relations they had with the then-revisionist Soviet Union, and 6) sow anti-Western imperialist sentiments in Africa (Muekalia, 2004: 5–12; Harris, 1985: 112). Prior to the 1970s, China-African relations were by and large ideologically driven. It provided financial support, equipment and training to a variety of liberation movements, particularly in Algeria, Angola, Congo, Mozambique, Namibia, South Africa, Rhodesia, etc. China's "involvement in the Non-Aligned Movement and other Third World conference type activities, were designed to demonstrate its own anti-imperialist approach to aid and to identify it with those nations that continued to suffer the effects of colonialism (Hamrin, 1986: 3).

Gu and Humphrey blame Africa's underdevelopment on colonialism. Beijing believes it has established the moral ground. From training "fighter for freedom" in the revolutionary 1960s and early 1970s to providing scholarships to children of African elites, China has been exporting its values for years. By successfully linking neo-colonialism with the neo-liberalism of Western countries, China has been able to win the hearts and minds of African elites (Gu, and Humphrey, 2006). To exemplify its commitment to a non-imperialist stand, starting in 1967, China began building the Tanzam Railway between Tanzania and Zambia. Following the death of Moa Zedong, however, the Chinese government gave less attention to Africa. Instead, China turned inward throughout the 1980 and 1990 to experiment with its new economic reform programs.

> "When Chinese economic reform began in 1978, the political leadership initially concentrated on a swift economic catching-up process, and attracted only relatively little importance to Africa in comparison with Western industrialized countries and Japan. For instance, between 1980 and 1987 the contribution pledged each year amounted to about $200-300 million, falling to a low point in 1988 of only $60.4 million. This comparatively low status was reflected in the rather sporadic visits by high-ranking politicians to Africa, a stagnating volumes of trade, and stagnating or even declining development assistance inputs" (Asche, 2008: 3).

Because of the global domination by the World Bank and International Monetary Fund's structural adjustment programs (which advocated extensive economic liberation and privatization), the China-African relations were partially eclipsed during the Cold War. Following the Tiananmen incident of 1989 (under the economic transformation initiated by President Deng Xiaoping), China renewed its engagement with Africa and referred to it as the Beijing Consensus. In order to feed its blooming economic need for resources (oil, minerals, timber, etc.) and to market its manufactured goods in Africa, China resumed its economic relations with Africa through an institutional framework known as the Forum on China-Africa Cooperation (FOCAC). In contrast to the West's view of Africa that chaos, conflict, corruption, and poor governance characterize its underdevelopment, China propagates that the African continent is rich in culture, religion, social dynamism, and energy. Realizing that the African continent has a great opportunity for business, the Chinese government encourages the following industries and projects to be invested in Africa: a) processing industrial products in the fields of electronics, machinery building, textiles, and garments, b) investing in agricultural products in order to add value to Africa's exports and improve Africa's terms of trade, c) extracting natural resources, such as petroleum and high-value minerals, and d) investing in infrastructure, power supply, and real estate development (United Nations, UNDP, 2007).

## Foreign Direct Investment

Realizing that Africa is marginalized in the worldwide distribution of foreign direct investment (FDI), China pledged government-backed foreign direct investment to African countries. In 2007, over 700 registered Chinese state-owned and private companies (provided with government financial backing) have entered into a number of business ventures in collaboration with African national governments, state-owned corporations, and private firms. For instance, the Chinese government has designated about 180 companies to benefit from preferential finance, tax concessions, and political backing to "go global" and become true multinationals (Alden and Davies, 2006: 83-96). Despite the government's support in leveraging Chinese businesses to go global, at this stage, Chinese investment in Africa is very low in comparison with other areas. For example, "Africa is attracting less investment, ranking in a mere US$317 million corresponding to 5.8% of total Chinese FDI outflows in 2005, in comparison to Latin America, which attracted US $1.7 billion accounting for 32%. Asia pulled off US$3 billion, representing 54.6% of total Chinese FDI outflows" (Rocha, 2008: 58). Though the motives of foreign direct investments might be 1) securing new markets, 2) raising efficiency, 3) securing raw materials, 4) obtaining cheap labor, and 5) securing defensive or offensive strategic advantages, the Chinese investments in Africa seemed be exclusively focused on securing raw materials and developing the markets for Chinese goods and services.

## Aid to the African Continent

The basic forms of the Chinese Development Cooperation, which is almost exclusively project-based, includes 1) giving grant aid (non-repayable loans to social projects such as schools, hospitals, housing, etc), 2) interest-free loans to finance infrastructure projects, and 3) preferential credits or concessionary credits (reserve-backed lending) with interests rates below the market level. Through the Export and Import (EXIM) Bank of China (the official credit agency of China established in 1994 to extend export buyer credits, export seller credits, and credits for investment, construction projects, and guarantees to promote Chinese investment in Africa), it lends to China's state-owned enterprises (SOEs) to promote their "Going Global" strategy. Though there is no distinction between development cooperation and commercial cooperation, the EXIM bank mainly assists the financing of infrastructures regarded very vital for extracting and transporting energy and mineral resources. According to Corkin and Burke, China's "state capital" approach to engagement through the likes of the EXIM Bank is answerable to political stakeholders, not private or institutional shareholders expecting short-term gains as in Western countries (Corkin and Burke, 2008: 43). The Chinese EXIM Bank, founded in 1994, is wholly owned by the state and operates under the central government. With the China Development Bank (CDB) and the China Agriculture Development Bank, the EXIM Bank is "tasked to promote exports and foreign investment. Its export credits focus on infrastructure (roads, power plants, oil and gas pipelines, telecommunications, and water projects); its investment loans target the energy, mining, telecommunication, industrial, and water projects. The bank's main source of funding is the bond market. Unlike export credit agencies in other countries, the government does not guarantee the bank's liabilities.

The EXIM Bank allows Chinese state-owned companies to invest in large-scale projects with returns that might emerge in the long-term. But all Chinese exports and investment abroad are insured against buyer and country risks, that is, foreign exchange restrictions, expropriation, nationalization, and war. "According to the requirements of China EXIM Bank, in principle, all contractors and exporters linked to the contract funded by a China EXIM Bank loam should be Chinese and 50% of all procurements should be from China. Such conditions give the Chinese companies advantage in terms of new market entry (Corkin and Burke, 2008: 43). By 2005, the Chinese EXIM Bank's portfolio had "tripled and its commercial operations outstripped those of its counterparts in the US, UK, and Japan" (Moss and Rose, 2007: 10). As a result, in terms of exports and imports, China has established itself as one of Africa's most important trading partners after the USA and is likely to have overtaken all the former European colonial powers in 2007 (Asche, 2007: 3). Nonetheless, it needs to be underlined that unlike the South-South cooperation which is based on the motto of exchanging industrial and non-industrial countries among the South partners, China exports mainly manufactured goods to African countries and the African countries on the other hand supply crude oil, minerals (iron ore, steel, copper, magnesium, diamonds), timber and agricultural products to China (China Commerce Year book, 2007).

## Trade

Using preferential trade as a window of opportunity for the development of Africa and opening new markets for Chinese exported goods, China has offered sizeable loans to various African countries. By the end of 2005, China's EXIM Bank approved loans worth US$6.5 billion for 260 projects in 36 African countries. But concessional and low-interest loans for infrastructure development amounted to US$12.5 billion. At the FOCAC summit in November 2006, President Hu Jintao announced that China would double its assistance by 2009, provide US$3 billion in preferential loans and US$2 billion in preferential buyer's credits to Africa. It has eliminated tariffs on a number of products that are exported by African countries (le Pere, 2008: 15). It needs to be highlighted that the Chinese government chooses Chinese construction companies to undertake large-scale projects and infrastructure development to encourage the expansion of markets and the entry of smaller firms in Africa. For instance, as of September 2006, China's committed 79 percent of its contracted investment in infrastructure development (Ellis, 2007). Between 2000 and 2005, China-Africa trade was $39 billion and is projected to reach $100 billion by 2010 (Alden, 2005: 147-164). Since 2000, Africa's exports to China have grown at a rate of 56 percent. Oil and mineral exports account for 85 percent of African exports to China. "The share of Africa's exports to China rose from 1.3% in 1995 to 9.3% in 2004, accompanied by a significant decline in African exports to OECD countries in the same period" (The Broker, 2007: 43).

## Development Assistance and Soft Loans

In its socially responsible development programs, China is donating development assistance and soft loans to various African states to finance their infrastructure projects, including roads, railways, access to fishing waters, hydropower stations, agricultural land, schools, and medical personnel. In 2006 alone:

> "There were more than 1000 Chinese doctors and nurses working in 36 African countries. At the Beijing Summit, Hu Jintao also announced support for 30 new hospitals in Africa, 30 malaria prevention and treatment centres and an additional US $38 million for the provision of artemisinin (a derivative of the Artemissia shrub) over the next years. By 2009, the government scholarships for African students to study in China is said would be doubled from their present 2000; and 15,000 African professionals will be trained in technical, scientific and administrative fields in 2007-2009" (le Pere, 2008: 15).

In addition, "with 26 African countries now being accorded 'Approved Destination Status' by China, it is projected that there will be 1 million Chinese tourists traveling to Africa by 2020, compared to the 110,000 in 2005" (le Pere, 2008: 18). In short, in contrast to Western hegemonies, China's bilateral state-centric engagement in Africa is based on the principles of sovereignty and non-interference in internal affairs. China's investment in Africa is driven to: 1) acquire the need for natural resources, energy supplies, and export markets to sustain its growing economy. Also, as stated by Aves, "Africa's long-standing preferential access to western markets offers 'back door' entry for some Chinese producers" 2) ascertain its belief that its development model is instructive for Africa; and 3) strengthen its diplomatic alliances essential to support its global ambitions (le Pere, 2008: 30). In other words, China's strategic incursion to Africa includes:

> "the use of public diplomacy, including high-powered official visits and a triennial Forum on China-Africa Co-operation (FOCAC), 2) China's pledge of large amounts of aid and investments in Africa's infrastructure and other sectors with no political strings attached, except withdrawal of diplomatic relations with Taiwan, and 3) the use of aid donations to encourage Chinese companies to acquire overseas assets, such as oil and industrial raw materials so that Africa could become a strategic training ground for Chinese companies" (JETRO, 2007).

In addition to being diplomatic, the Chinese investment, trade, and infrastructural assistance help the African continent diversify its exports. But, it needs to be underlined that through government endorsed contracts, the Chinese EXIM Bank requires that in all overseas financing, the Chinese contract must ensure that they include export spin-offs in the long run from China. For instance, in the short run, while local and other foreign construction companies operate on profit margins of 15-25%, Chinese companies usually operate on margins of under 10%, making them extremely competitive. Large Chinese owned enterprises (SOEs) generally slice their profit margin to undercut other competitors. Despite the enormous challenges China faces concerning its own development, Beijing's focus on infrastructural development in Africa, with the construction of roads, bridges, hydroelectric and irrigation schemes, schools, hospitals, health centers and an array of government buildings, has driven private sector competition and made a clear and definite contribution to improving the lives of people across Africa (Corkin and Burke, 2008: 45). Africa needs to ascertain that the Chinese investments are transformative and are likely to extricate the African continent from the doldrums of underdevelopment. However, instead of mirroring Africa as a mere beneficiary of Chinese benevolence or as a renter continent, that is, the African state governments are recipients of the external rent and do not require a strong domestic sector, the Chinese cooperative assistance offers need to inspire alternative routes to an environmentally sensitive development based on a win-win strategic partnership.

Rocha declared that it is indisputable that China's engagement with Africa is producing positive results in the economic dimension of development. However, it is also clear that this engagement is not yet producing any meaningful impact in the lives of ordinary citizen. Instead of investing in its people and other productive activities, some countries are channeling the revenues generated towards unsustainable consumption patterns. Further, Africa's natural resources base and ecosystems are under continuous threat arising from an increase in exploitation activities. Under such circumstances, the "resource curse" is likely to fall upon some of the resource rich African nations (Corkin and Burke, 2008: 64). For example, in 2006, Angola signed with China for the construction of an oil refinery to enable Angola to meet increasing domestic demand and increase supply to regional markets with the Southern African Development Community. However, the negotiations broke down because instead of abiding by the intra-Africa trade, China insisted that the bulk of the refined oil be exported to China. Since China has not come out with environmentally sensitive programs, 30% of the forest logging concessions given to China in Central Africa is expected to precipitate an increase of carbon emissions. If the various mining concessions held by China in Africa do not comply with environmental laws, it is possible that they might be a health hazard and could impair human security. For instance in Gabon, the Chinese oil company was accused of "a whole range of unacceptable practices including pollution, exploding dynamite, and carving roads through parks. In addition, environmental and human rights groups, and businesses, are irked by some unsavory aspects of the Chinese profile, such as the deployment of Chinese labor, which limits local employment opportunities, destroys local manufacturing capabilities, and sustains poor labor and environmental standards" (JETRO, 2007). As articulated by Rocha:

> "Since Cameroon, Congo, the Democratic Republic of Congo, Equatorial Guinea, Gabon, and Liberia are all major suppliers of timber to China, the conduct of industry in the Congo Rainforest has serious ecological and other implications for the entire continent. There are already indications that the effects of climate change will be most severe in Africa. Thus, continued mismanagement, in all its dimensions, of Africa's natural resources, renewable and non-renewable, will have catastrophic consequences for the continent" (Rocha, 2008: 63).

On the other hand, some other African countries state that the presence of the Chinese in their countries is not only instructive but also contributes to positive spin-off, positive results. For example, Mr. G. D. Boateng, Executive Secretary at Ghana's Secretariat of the Chinese funded Bui Dam Project argues that "With Chinese assistance, old development plans that were jettisoned at the insistence of development partners are now being revived and are being executed at much lower costs. Before the Chinese came, the BUI Dam project had been on the shelf since the 1960s. We had expressions of interest from a number of Western companies in the 1960s and in 2001, but they all fell through because those companies didn't see the project as a worthwhile project. Now with Chinese assistance the project has gone off the shelf to the ground and this time it is an integrated project that includes the building of a new city around Bui" (JETRO, 2007). Also, in Lesotho, very important growth in the textile and clothing industry has been recorded as a result of investment from Asian firms. What is achieved in Lesotho "is the process of growth leading infrastructure as Chinese and Taiwanese investors demand improved infrastructure in transport, energy and water, all necessary for profitable operations in the sector" (Gelb, 2005).

On the whole, unlike the Western competitors, China makes no value demands that its aid be intertwined with investments and provides generous support for the expansion of Chinese companies into the African markets in order to diversify its source of supply for its industrial inputs. Based on this, a number of African governments seem to be satisfied with the Chinese contributions to the expansion of their infrastructure, tapping unexploited resources, integrating Africa's economies into global value chains, and visualizing China as a model for Africa's development. Despite the fact that domestic companies feel that they are being crowded out and there are shortfalls in the transfer of know-how and employment of local workers, a number of policy makers in Africa go one step further to justify that China has brought economic sanity to impoverished and conflict-ridden neighborhoods in Africa (Asche, 2008: 3). To make China be influential and a credible source for Africa, a number of African countries have endorsed themselves to be a strategic training ground for Chinese state-owned enterprises, as well as private enterprises, in order to quench their thirst for oil and industrial raw materials (JETRO, 2007). Being the trailblazer from Western dictates, the Chinese Export-Import Bank has played a major role in low-cost financing development, cooperative projects, and coordinating the effort of Chinese state-owned corporations and private enterprises.

Nevertheless, it is worth noting that the growth of South-South development cooperation in Africa is not likely to fundamentally change the terms of the relationship between Africa and the Western industrialized countries (North), but it can definitely be ascertained that the Africa continent has leveraging power to bargain with prospective Western investors (Gelb, 2005). The China-investment projects are in the process of generating development cooperation in resources, that is, (oil, mining, timber, agricultural commodities), trade and investment, and contracts for construction and engineering projects (roads, bridges, schools, shopping centers, housing and office buildings, water conservancy, and power plants) for Africa's present and future generations. Though very vital, African states thus far "have not developed strategies of their own that underpin their cooperation with China" (Asche, 2008: 3). Therefore, if Africa is to extricate maximum benefits from its enhanced cooperation with China it needs to design its own game plan and allocate a specific role for China based on a common agenda at the continental level. Being engaged in constructive exchange, Africa simply needs to redefine the rules of the game to make it more amenable and less threatening to its own interests (Rocha, 2008: 55). For example, in South Africa, Chinese investments are "the product of lengthy and detailed negotiations that–apparently unlike some deals struck in other African settings–are framed in terms which conform to international legal norms and responsibilities" (Alden and Davis, 2006: 83-96).

Due to limited cross-cultural communication, there seems to be lack of collaboration between the Chinese and African employees. The composition of the personnel in most of the over 800 state-owned Chinese firms, Africa seems to be dependent on Chinese experts. The Africans workers are busy accomplishing semi-skilled and manual types of work in textiles and clothing and the logging of tropical timber. The highly skilled and senior managerial personnel are brought from China and are mostly engaged in extractive industry (oil, gas, and mining), hydroelectric, and civil engineering. In addition, with Chinese infrastructure projects, local construction firms are crying foul with respect to Chinese bidding practices and with the overwhelming Chinese involvement in the composition of the semi-skilled labor force. This might be possible because the Chinese are not adequately trained in cross-cultural communication skills to effectively deal with their African counterparts. Even if the Africans are not highly trained in engineering and construction, as part and parcel of the Chinese co-development strategy, the main purpose of Chinese investment in Africa should have been to train and upgrade the skills of local personnel so that Africa could be in a better position to replace the highly skilled Chinese employees and investors in the near future. African governments should be in a position to monitor that the Chinese companies are contributing to improve the skills of the local workforce even if they may initially employ expatriate skilled technical and management personnel. Thus, the Chinese need to establish local educational infrastructure and provide training opportunities to adequately prepare the prospective African employees (United Nations, UNDP, 2007).

Based the review of the literature, the socio-economic impacts of some of the Chinese cooperative investment in Africa are summarized using the following dimensions: a) local employment b) human management skills (control of decision making process), c) technological transfer, d) local content requirements, e) efficiency, and f) the terms of trade (See Table 1). The Chinese investors seem to be in control of decision-making and are involved as heads of the business functional areas (human development, accounting and finance, marketing, production and operations). Research and development (R and D) for all China-African investments are also controlled by state-owned enterprises and government-approved private agencies. Typically, state-owned companies arrive in Africa with their own work force, mainly project managers, engineers, technicians (Wang, 2007). Unless corrected, the China-African investment is likely to fatten the pockets of state elites and marginalize the African masses. In line with the objectives of the South-South Cooperation, the degree of control must be reversed if there is going to be technological transfers from China to Africa. Also, China has done little to integrate Africa into the global value chains. It is claimed that Chinese capital investments in Africa are new (Greenfield) rather than takeover investments. Chinese investments in Africa are constrained by not being environmentally friendly. Though an essential part of the technology transfer package, it is worth mentioning that a review of the literature shows that the China-African investments, similar to the Euro-African, have failed to handle Africa's negative environmental externalities.

**Table 1: Impact of Chinese Cooperative Investments in Africa**

| Indicator | Aggregate Analysis of the Effects of Chinese Investments in Africa |
|---|---|
| Local employment | In general, the Chinese are employed in highly skilled jobs where as Africans are mainly engaged in lower skill jobs |
| Human Capital | |
| Chief Executive officer/organizational structure | Mixed |
| Accounting & finance | Mixed |
| Marketing | Local for local products |
| Production and Operations | Mostly Chinese |
| R&D and Product Design | Mainly Chinese |
| Technological transfer | |
| Engineering Specification | Mostly accomplished by Chinese |
| Human Capital and Development | Very minor training given to local employees |
| Productivity | The China-Ethiopian firms are very productive |
| Environmental Effect | Generally negative impact on the continent |
| Technological Infrastructure for Backward and Forward Linkages | Mixed impact |
| Local Content Requirement | Less than 50% of supplies are obtained from domestic sources |
| Efficiency | Per unit cost of goods and services produced by the China-African investment is cost effective |
| Foreign Exchange | Mostly supplied by China's EXIM and China Development Bank |
| International Marketing | Thus far, most of the products are sold in the domestic markets |
| Boosting Exports | Limited domestic manufactured products for the international market, China heavily exports Africa's primary products |
| Boosting Imports | The Chinese have heavily flooded African markets with cheap and poor quality products from China |

(World Economic Forum, 2007; Asche, 2008: 3).

African firms generally lose about 8 percent of sales due to power outages, and transportation delays account for about 3 percent lost sales (Zafar, 2007: 103-130). The Chinese construction companies are currently able to wind up to a third of all public tender processes in Africa to electrify a number of places and speed up the transportation process. The African governments see this as a means of obtaining construction services more cheaply and more quickly than obtaining them from Western construction firms. Nonetheless, it is instructive to notice that about 30 to 40 percent of the orders that come from China are being executed by Chinese firms, in collaboration with African local personnel and subcontractors (Asche, 2008: 3). In 2006, Africa's exports to China were composed of oil and gas (about 62 percent), minerals and metals (about 13 percent), and manufactured goods (8 percent). The main imports of Africa from China included about 45 percent manufactured products, 31 percent machinery and transport equipment, and about 24 percent primary products. "Rough estimates suggest that Africa's terms of trade (the ratio of Africa's export price index to its import price index) in relation to China improved by 80 to 90 percent between 2001 and 2006 (Wang, 2007). More specifically, the terms of trade of the 48 Africa countries can be divided equally into winners (for example, oil exporting countries), winner-losers, and losers (oil-importing textile producers such as Madagascar and Mauritius, coffee producing and other agricultural exporting countries) (Kennan and Stevens, 2005: 33-42).

While Chinese exports to Africa are poor in quality, they are generally cheaper to African consumers. The export driven strategy of China has contributed to huge job losses in a number of manufacturing industries throughout the African continent. For instance, instead of supporting domestic enterprises through backward and forward linkages within the domestic economy, the footwear industry in Ethiopia has been facing pressures from cheap Chinese imports (Egziabher, 2007: 4-8). In addition, although cotton growers in West Africa have benefited from increased exports of raw cotton to China, "nevertheless most observers today share the concern that by purchasing raw materials from the continent and selling value-added products back, China's increased involvement will create unfavorable trade balance for many African countries" (Broker, 2007). The importation of Chinese manufactured textiles to Lesotho, Kenya, and South Africa with well established clothing industries has flared up social unrest and disruption by trade unions (Alden and Davies, 2006: 83-96). As stated above, Chinese economic involvement on the African continent has contributed to a surge of low cost consumer goods. But, the importation of higher value-added products such as refrigerators, air conditioners, and other machinery products have not stimulated but displaced local products and laborers.

Efficiency, seeking and using local content inputs for export, oriented manufacturing Chinese investments have been very limited in Africa (United Nations, UNDP, 2007). "In recent the years Chinese entrepreneurs, often traders, have been traveling or migrating to Africa to seek business opportunities. Once established (teaming up with local business) in African towns, these entrepreneurs set up wholesale or retail outlets and import from China consumer goods like electronic appliances, textiles, and clothing, competing with local traders" (ECOWAS-SWAC/OECD, 2006). To summarize then, the internationalization of Chinese investment in Africa has been accelerated in recent years in manufacturing (textiles), resource extraction, construction and other services. China's incentives to promote FDI outflows to Africa take four forms: a) special and general tax incentives (All Chinese enterprises overseas are exempt from corporate income tax for five successive years after beginning operations); b) loans and credit (Chinese enterprises with investments abroad are accorded medium- and long-term commercial loans or soft loans from government-owned Chinese banks); c) foreign exchange (China's foreign exchange administration stipulates that Chinese enterprises are eligible for foreign exchange for foreign investment projects); and d) a favorable import and exports of raw materials and services (United Nations, UNDP, 2007). Based on the current Chinese investments and co-development projects existing in Africa critics argue that China is not only flooding the African markets with cheap consumer goods but also is devastating the local textile and other consumer product industries. In addition, they persuasively argue that as yet a) there is little evidence whether China's renewed, and most probably lasting involvement in Africa will serve the continent better than the decades of aid from Western governments, which have scarcely delivered on their promises; b) while Chinese FDI is contributing to economic growth (especially in resource-endowed states), apart from an infrastructure construction boom, "there is little evidence of a positive impact on broader human development" and c) "China has an African Policy. Africa doesn't have a China policy" (Broker, 2007).

On the positive side, the supporters of Chinese investment in Africa argue "Africa registered 5.8 percent economic growth in 2007, its highest level ever, in part because of Chinese investment. Experts say the roads, bridges, and dams built by Chinese firms are low cost, good quality, and completed in a fraction of the time such projects usually take in Africa" (Hanson, 2006). In short, proponents of Chinese investment in Africa claim that China has not only provided assistance but has also invested in Africa in areas that the Western aid agencies and private investors have long neglected. For instance, though agriculture is regarded very vital for Africa's development, both the United States Agency for Development (USAID) and the World Bank reduced assistance to Africa's agriculture by as much as 90 percent in the 1990s. The Chinese state-owned enterprises, on the other hand, provided human and capital assistance to Africa without any conditionality (Lake and Whitman, 2006: 147-148). Though instructive, the two diametrically opposed perspectives of the Chinese engagement in Africa deepen further research and analysis. For the last few years, Ethiopia has achieved a high and sustained rate of growth. Given the fact that Ethiopia has been the major beneficiary of Chinese investment and cooperative development projects, the question which needs to be pondered is therefore: can some of Ethiopia's spectacular growth rate be attributed to the Chinese investments? More specifically, have the Chinese cooperative investment footprints enabled the Ethiopian economy to master high valued technology and generate productive employment or have the various co-development Chinese investments deepen Ethiopia's economy on the Beijing consensus model?

# CONCLUSION

Emerging discourse on the China-Africa relationship depicts China either as the new imperial power or as Africa's benefactor. In the West, reaction to China's involvement in Africa has bordered on suspicion and paranoia. Policy makers and analysts in the West are concerned that China could gain control over Africa's vast and untapped natural resources, particularly the continent's energy reserves. The current struggle over Africa's resources evokes worrying memories of an earlier scramble for pieces of the continent in the late nineteenth century by Western European powers and in the 1950s and 1960s by Eastern powers, principally China and Russia. China's involvement in Africa has serious implications for Africa and Africans. Instead of paranoia, this paper calls for guarded optimism regarding the deepening relationship between Africa and China. With China confident emergence on the global stage as the economic empire of the future, it would be ill advised for African leaders to turn their backs on the sleeping giant. However, while there is much that Africa could gain from the relationship, African leaders and Africans must guard against imperialism of any sort and shy away from arrangements that threaten sustainable development in the continent or undermine respect for human rights and human dignity. Most important, African leaders must push past Beijing's rhetoric of anti-hegemonism and develop clear policies to guide the continent's engagement with China. Drawing on the rich but sad lessons of tehnological scramble for Africa in the nineteenth century, African leaders must avoid the economic, political and legal pitfalls of the past and position the continent to benefit from strategic relations with their future partners.

# REFERENCES

Alden, C. (2005), China in Africa, *Survival*, 47 (93), pp.147-164.

Alden, C., and Davis, M., (2006), A Profile of the Operations of Chinese Multinationals in Africa, *South African Journal of International Affairs*, 13 (1), pp.83-96.

Anshan, L, (2005), African Studies in China in the Twentieth Century: A Historiograpghical Survey, *African Studies Review*, 48, p.1.

Asche, H., (2008), China's Engagement in Africa-Opportunities and Risks for Development, Hamburg: Africa Department, *Economics Affairs*, p.3.

C. L., Hamrin, and T. Cheek, (1986), (eds.), *China's Establishment Intellectuals*, Armonk, NY: M.E. Sharpe.

China Comerce Yearbook, 2004, p.615.

Corkin, L. and Burke, C., (2008), Constructive Engagement: An Overview of China's Role in Africa's Construction Industries, A publication of the Centre for Chinese Studies (CCS), *Chinese Studies at Stellenbosch University*, South Africa, p.43.

ECOWAS-SWAC/OECD, (2006), Africa and China Economic Series of the Atlas on Regional Integration in West Africa, from http://www.atlas.estafrica.org 05.12.2006.

Ellis, Linden J., China Exim Bank in Africa, China Environmental Forum, *Woodrow Wilson Center for Scholars*, from http://www.atlas.estafrica.org, 22.03.2007.

GebreEgziabher, Tegegne, (2006), The Developmental Impact of China and India on Ethiopia with Emphasis on Small Scale Footwear Producers, *Development Policy Research Unit*, Johannesburg, South Africa, pp.4-8.

Gelb, S., (2006), South-South Investment: The Case of Africa, Africa in the World Ecnomy-The National, Regional and International Challenges, from http://psdblog.worldbank.org/psdblog/2006/03/chinas_investme.html, 20.03.2006.

Gelb, S., (2005), "South-South Investment: The Case of Africa." Africa in the World Ecnomy-The National, Regional and International Challenges, from http://www.google.com/search?q=References:+Gelb,+S.+(December+2005).++%E2%80%9CSouth-South+Investment:+The+Case+of+Africa.%E2%80%9D+Africa+in+the+World+Ecnomy-The+National,+Regional+and+International+Challenges.&hl=en&start=10&sa=N&filter=0, 15.12.2005.

Gu, Jing, and Humphrey, J., (2007), The Impact of Africa on China, African Economic Research Consortium Working Paper No. ADWP-05. Retrieved October 31, 2008, from http://www.jcer.or.jp/eng/research /assia.html

Hanson, S., (2006), China, Africa, and Oil, *Council on Foreign Relations*, Retrieved July 12, 2008, from http://www.cfr.org/publication/9557/,06.06.2006.

Harris, L. C., (1985), China's Foreign Policy Toward the Third World, *The Washington Papers*, XII, P.112.

JETRO, (2007), Africapractice: The Impact of the Chinese Presence in Africa, In Isaac Idun-Arkhurst and James Laing, (eds.), London: Africapractice, from http://www.google.com/search?q=References:+Africapractice:+The+Impact+of+the+Chinese+Presence+in+Africa,+Isaac+Idun-Arkhurst+and+James+Laing+(eds).&hl=en&filter=0, 04.26.2007.

Jian-Ye, Wang, (2007), What Drives China's Growing Role in Africa? Washington D.C: International Monetary Fund Working Paper, 07/211.

Lake, A., and Whitman, Christine T., (2006), More than Humanitarianism: A Strategic U. S. Approach Toward Africa, New York, Council of Foreign Relations Independent Task Force Report No. 56, pp.147-148.

Le Pere, G., (2008), Prospects for A Coherent African Policy Response: Engaging China, New Impulses from the South: China's Engagement of Africa, Hannah Edinger, et al., (eds.), *Centre for Chinese Studies*, University of Stellenbosch, South Africa, p.14.

Linden J. Ellis, (2006), Summary of China Exim Bank in Africa, Role of ODA, Paris, *DAC Guidelines and Reference Series*, pp.9,17.

Moss, T., and Rose, S., (2007), China's Export-Import Bank and Africa: New Lending, New Challenges, *Centre for Global Development*, Washington, D.C, p.10.

Muekalia, D. J., (2004), Africa and China's Strategic Partnership, *African Security Review*, 13 (1) pp.5-1.

Rocha, J., (2008), China and African Natural Resources: Developmental Opportunity or Deepening the Resource Curse? *Chinese Studies at Stellenbosch University*, South Africa, p.58.

Stevens, C., and Kennan, J., (2006), How to Identify the Trade Impact of China on Small Countries, IDS Bulletin, 27 (1), pp.33- 42.

The Broker, (2007), "China and Africa, How will the Beijing Consensus Benefit Africa?" From http://www.thebrokeronline.eu/en/layout/set/print/articles/How-will-the Biijing-Consens.12/31/2008.

United Nations, UNDP, (2007), Asian Foreign Direct Investment in Africa: Towards a New Era of Cooperation Among Developing Countries, New York: United Nations.

World Economic Forum, (2007), Africa Competitiveness Report, Washington: World Bank.

Zafar, A., (2007), The Growing Relationship between China ad Sub-Saharan Africa: Macroeconomic, Trade, Investment, and Aid Links, *The World Bank Research Observer*, 22 (1), pp.103-130.

# MANAGEMENT OF THE GOVERNMENTAL SUPPORT OF RUSSIAN AGRO-INDUSTRIAL COMPLEX ON ENTERING THE WORLD MARKET

**Kuznetsov N.G.,**
**Rostov State University of Economics, Russia**
**Ovchinnikov V.N., Soldatova I.Y., Churikova K.S.,**
**South Federal University, Russia**

## ABSTRACT

*The main object of this report is an entry of Russian agro-industrial complex into the world market is the management by price policy and non- price policy forms of support of producers, which is the most important factor in forming a new geopolitical status of the country and its strategic management in the world arena.*

*The problem of the governmental regulation of the agro-industrial complex is in price policy and non price policy forms of support of producers, a strategic choice of these forms revealed itself specifically in the agricultural sector of economy, especially in the export and import of agricultural products, where the transformational recession rates happened to be the highest, and the consequences of the crisis are threatening the provisional safety of the country.*

## INTRODUCTION

The share of the agricultural production in the world trade is reducing significantly. In 1950, agricultural production exceeded a third of the world trade; by now it has reduced to one tenth. While the world agricultural production has been multiplied up to 5 times with in the last 10 years, and has reduced its share in the world trade, in Russia, agricultural production has increased only in 2.4 times; the share of Russia in the world agricultural production has been reduced from 5% down to 2%.

In agriculture and food industry produces about 8.5% of gross domestic product (including in agriculture, 4.4%), it employs 7.1 million people (about 11% of those employed in the whole economy) concentrated 3.6% of fixed assets. Russia has one of the world's largest agricultural potentials. It accounted for 8.9% of the world's arable land, 2.6% pasture, 20% of the world's fresh water, 8,3% of the production of mineral fertilizers.

Content, forms and methods of the agro-industrial policy in Russia, in the European Union, in USA are being transformed considerably (Serova E. V., Shik O.V. (2007) World Agrarian Policy, Government University Publishing Company, Moscow; data OECD; Federal services of the State Statistics, Russia and Countries of the World, 1986-2007 etc.) The majority of the state methods are due to the regulations of the income increase of farmers .These methods can be sorted into two groups:

- effecting the reduction of costs of production;
- effecting the growth of aggregate income of farmers.

## METHODS AFFECTING THE REDUCTION OF COSTS OF PRODUCTION

The main method of reduction of the production costs is subsidizing of all production expenses, which is equivalent to their price decrease for a farmer (while the market price for the resources stays the same). The state subsidizes particular production expenses: gaining fertilizers, means of defense, improvement of the land fertility, restoration of the violated lands, irrigation, drainage and etc.

Farmers are able to gain access to the financial resources on the privileged rates. Subsidizing of the expenses on resources increases the income of farmers, and also causes the increase of the demand on subsidized resources and interrelated resources, increases the magnitude of the supply of according goods and services.

In addition to methods, reducing the production costs of farmers, other methods, which cause the reduction of the amount of purchased resources, can be related to the ones above, which is possible based on the productivity of agrarian production, usage of resource saving technologies, perfecting the methods of organizing the work and management.

## METHODS AFFECTING THE GROWN OF AGGREGATE INCOME OF FARMERS

The state policy of the growth stimulation of aggregate income of farmers includes three main areas:

- maintaining the growth in prices of the agricultural products;
- stimulating the volumes of releases of the agricultural products;
- combination of the two methods above.

Realization of the purposes listed above can be achieved by using four possible approaches:

- the policy of the release volume stimulation of the agricultural products;
- policy of the price subsidizing of the agricultural products;
- control policy of importing the agricultural products;
- control policy of the national release volume.

Realization of approaches of economical policy, listed above, has a variety of effects in countries, where exporting and importing volumes have a great influence on the world prices in agrarian market.

## POLICY OF SUPPORTING PRICES

The most important political method of the growth income is maintaining the prices (Kleiner.G, System structure of economy and economic policy, (2006)). It includes two main approaches:

-subsidization of price per single unit of a product;

- subsidization of a price above the market price in order to compensate the difference between the market price and the currently stated guaranteed price.

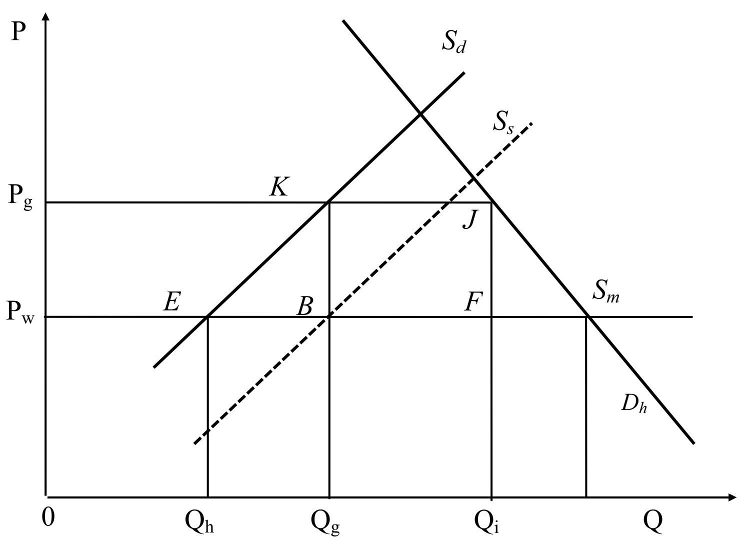



**Fig.1. A Regulation Mechanism Of Prices Of Agricultural Products For Countries With Open Economics**

Figure 1 can be seen the mechanism and consequences of public policy to stimulate output of agricultural products in countries where exports and imports of agricultural products do not have a significant value at world prices. Understood the case of an open economy, i.e. exports and imports are not subject to state regulation.

An important focus of policy proceeds is to support prices. It includes two main directions: unit price subsidies and subsidies for more than market price, in order to compensate for the difference between market price and a guaranteed fixed price. In any case, it should be borne in mind that if you stimulate the volume of production gives rise to the trend of reducing prices, the subsidies will create price trend output growth For the first group of countries, the volume of imports and exports which do not affect the volume of world production subsidy policy implications can be illustrated by using the schedule in Fig.1.

Suppose the value of subsidy per unit of output will be PwPg, for producers is equivalent to the reaction to increase the market price to the value Pg. The volume of proposals for such a price represents the value Qg . According to the law of the market equilibrium curve shifted to the right to point B. Suppose further that the price Pg - is guaranteed by the state price. It will be an effective tool to encourage manufacturers only if more than the market price. Curve in this case will then appear QgBKSd**.** Stimulating effect of this policy will be the greater, the smaller the individual producer price compared to market price. Both types of policies conducive to increased domestic supply and reduce imports. Total income of agricultural producers with increased value 0PwEQh to 0PgKQg. The grant will be PwPgKB. The use of price support policy needs to take into account the elasticity of supply factors in the short and long periods. On the one hand, the response of producers to support prices reflected more in the long term, on the other hand, difficult to predict changes in the prices of other products over time.

In general, the policy of supporting prices in the agricultural sector should be applied when the policy of supporting prices contributes to the income growth of the owners of factors of production; the income of consumers with relatively high income is reduced; the government has a set of strongly pronounced redistribution preferences; expenses of the support price fixed by government are relatively low (this condition will be adhered, if the demand and supply are relatively inelastic in the short-term period); the direct administrative expenses are relatively low, which is more common for the importing country; the budgetary costs are relatively low;
other costs, caused by applying less contradictory instruments, are quite high.

## METHOD OF REDUCTION AND GROWTH IN EXPORTING AND IMPORTING VOLUMES

A significant difference of the analyzed types of policies reveals itself as soon as we consider the influence of the world price. Subsidization of the production unit of the supplier will have an increase of the national supply volume prior to the lowered price as a consequence, since subsidization – is a fixed quantity of the added price to the market price. In case of the compensation policy of the price difference, the supplier will be getting it until the guaranteed price goes down to the same level as the world price.

The differences from the countries, which do not have a significant influence on the supply proportions of the world market, are as follows: the consuming price will be declined according to the growth of consuming the more compensational payments lead to a decline in the world prices, the greater the quantity of the subsidization the wealth of the community increases according to the price decline of the imported goods a replacement of import and the growth of export, resulted by subsidizing, can cause an international depressing influence on the world prices

Since in both cases, the consequence of the subsidizing policy is the increase in the supply volumes, it must be taken into consideration that the result will be defined by the supply price flexibility, and therefore, it will have significant differences for different kinds of agricultural products.

The parity policy of the prices is about setting the support for the minimum prices on the agricultural products. As a matter of fact, these prices are higher then the equilibrium ones, therefore, according to the law of the demand and supply, the parity policy leads to forming of the excess of agricultural products. As a result of the parity policy, the agricultural suppliers are getting an upper hand, since their income is stabilized on a maintained level. The consumers and the community in general, are undergoing declines. The consumers pay by high prices and consume a lesser amount of products. The maintained prices also cause international economic deformations and set a barrier as a quotes and tariffs being more effective foreign suppliers.

## METHODS OF NON PRICE APPLY

Ministry of Agriculture of Russia in 2007 introduced the practice of the economic mechanism of budgetary funds for the medium term**.** The relevance of the adoption of the State program is determined by the fact that agriculture has been and remains one of the major industries in Russia and in the world economy.

In agriculture and food industry produces about 8.5% of gross domestic product (including in agriculture, 4.4%), here employs 7.1 million people (about 11% of the number of employees throughout the economy), concentrated 3.6% of fixed assets. Russia has one of the world's largest agricultural potentials. It accounted for 8.9% of the world's arable land, 2.6% pasture, 20% of the world's fresh water, 8.3% of the production of mineral fertilizers. The development of the State program is an exceptional value of agriculture in the provision of high quality food industry - raw materials.

The first state program requires a systematic approach to addressing the production, financial and social problems in the industry. It should be noted that the priority national project "Development of Agroindustrial Complex", as federal and departmental earmarked programs, form its core, a whole farm policy in 2008 has become a priority of state policy. This creates the prerequisites for reducing poverty and improving food security. Moreover**,** departmental target programs are a new tool for medium-term planning of ongoing activities and create favorable conditions for the development of industries and sectors of the economy. As a priority development sectors of agricultural production, livestock selection, due to increasing demand for livestock products as incomes increase. Animal husbandry sector in comparison with the crop is a long production cycle and high infrastructure costs. The development of animal husbandry from the federal budget allocated 47.5 billion rubles. 1 state program provides subsidized investment loans for construction and renovation of animal facilities; grants for the reimbursement of expenses of the sheep and the goats,

deer and horse meat herd. It is also proposed to support the growth of tribal affairs in the livestock sector. In 2008, for this purpose provision is 2.7 billion rubles, that 2 times the level of 2007. In 2012, the level of public support for the event will be 5.1 billion rubles that exceeds the level of 2007, almost 4 times. The state program provides for reimbursement of costs for the purchase of young breeding and breeding material of agricultural organizations and the peasant (individual) farms, which will be an important factor in improving productivity and efficiency of livestock.

## REGIONAL PECULIARITY

Regional peculiarity is considered to be one of the most important aspects in methodology of managing economy in agrarian sector. Regional support system becomes dominant amongst the other sources of state support system in agrobusiness (federal budget, regional budget, a fund of beneficial crediting). Effectiveness of regional policy shows itself in flexibility, high opportunities in controlling the usage of budgetary means. Absence of prerequisites, listed above, on a federal level, rapidly decreases the effectiveness of budgetary means regulation.

## CONTRADICTORY CONSEQUENCES OF APPLYING THE METHODS OF SUPPORT

Generally, the support of the state in agrarian production must be accompanied by a serious estimate of possible conflicts of purposes and disorders, rising in the process of regulation. The price support and non price support the most contradictory instrument of management in the agricultural policy, since the price issued by the government gives a wrong signal to both producers and consumers (Table 1).

**Table 1:Contradictory Consequences Of Applying The Methods Of Support Of Producers Of The Agricultural Production**

| Method of management | Contradictory consequences |
|---|---|
| Stimulating the growth of the national production volume | - growth tendency of the producers' aggregate income will be weakened by an according price cut;<br>- the national agrarian policy has global consequences according to its influence on the supply volume of the agricultural production; |
| The price parity policy | - formation of a agricultural production surplus;<br>- the price growth of the agricultural production in the domestic market;<br>- the decrease of consumption volume;<br>- tax increase in order to compensate the increasing prices and the storage expenses;<br>- decline in public welfare as a result of irrational redistribution of the means into the agrobusiness;<br>- deformation in the world agricultural market, caused by disturbance of the market signals; |
| The import taxes | - the price growth of agricultural products; |
| The structural policy | - while the population migrates from rural areas, providing cost of public goods per capita increases;<br>- a long term decline in the economic potential of agricultural regions; |
| The direct support of income | - significant budgetary expenses;<br>- the problem of the administrative control and a high level of transactional costs;<br><br>- a slowdown of structural changes in agrobusiness;<br>- forming irrational expectations of the producers in agrobusiness; |
| Subsidization of production expenses | - growth of budgetary expenses;<br>method is successful, if it doesn't contradict the producers' pricing policy; |
| The price support | - the producers' reaction shows itself in the long-term outlook;<br>- long-term prediction of how the other products' price will change, is very abstract;<br>- the more compensatory payments lead to the decrease in world prices, the more subsidies are needed;<br>- import replacement and export stimulation are likely to have a negative effect on the world prices; |

## CONCLUSION AND RECOMMENDATION

The most adequate method in the current times of Russia, from the principles of method rationalization point of view, is the price support and non price support of the agricultural suppliers. Supporting the methods of budgetary policy can be effective only in the effective coordination of the federal and local control, presence of the according control mechanisms of the addressed usage of budgetary means.

The structure and budget parameters for consideration of the major indicators of draft state program provide for the allocation in 2008 - 76,8 billion rubles in 2009 - 100 billion rubles in 2010 - 119,5 billion rubles, in 2011 - 125, 0 billion rubles in 2012 - 131.7 billion rubles. The resources for the five-year implementation of state of more than 550 billion rubles from the federal budget. Budget for agriculture in 2012 increased by 2 times compared to 2007. Attracting investment in fixed assets of agriculture for the years 2008-2012 could reach 1trl. rubles**.** In accordance with the Law «On the development of agriculture» is an effective mechanism for monitoring and evaluating the progress of implementation of state. Yearly evaluation of the results of the program will be implemented by an expert committee. Its members will include representatives of industry associations and associations of agricultural producers and consumers of agricultural commodities and food, representatives of federal executive authorities, authorities of the Russian Federation**.** The website of the Ministry of Agriculture open access will provide information on the content and implementation of program activities. Every year, in Russia the Ministry of Agriculture will prepare a national report on the progress and results of the state program and after its approval by the Government will be sent to the Federal Assembly.

## REFERENCES


Agricultural Economics and Policy: International Challenges for the Neinties. Essays in Honour of prof. J. De Veer. Elsevier, (1999), Amsterdam

EC Agricultural Policy For The 21st Century, (1994), *European Economy*, (4)

Sharonov A. (2008), Criteria of economic security, *Questions of economy,* (10).

Kleiner.G., System structure of economy and economic policy, (2006), *Problems of theory and practice of management*, (5)

Kostysenko I. (2002), World external trade and the potential of Russian regions. *Business Academy.*4 (14)

Compellation of statistics «Agriculture of the Rostov Region»: Compellation of statistics/Rostoblstat. – Rostov-on-Don, 2008

Serova E. V., Shik O.V. (2007) World Agrarian Policy. Government University Publishing Company, Moskow

Veeman Michele, (1990), The Political Economy of Agricultural Policy, *Canadian Journal of Agricultural Economics*, (38)

Vermel D., Hromov Y., (1997), Problems of food safety in Russia. External and internal aspects, *Agro-industrial complex: economy and management, (1)*

Vinslav.Y.,(2001) Development of the Russian corporative management: theory, practice, ways to solve key problems , *The Russian economic journal*, (2)

Willem H. Buiter, Globalisation and regional integration; a view from Eastern Europe and the FSU / NBER Working Paper, 2001

www. AAEA. org

Zeldner A., (2000), Priorities, institutions and mechanisms of way out of agricultural crises in the XXI century, Russian Academy of science, Moscow publishing company

**Appendix 1Plan budget of the project «Priority actions for the development of agribusiness»**

| Activities | 2006 | 2007 | Total, billion rubles. |
|---|---|---|---|
| **Management accelerated development of livestock** | | | |
| Subsidization of the cost of paying interest on loans obtained for up to 8 years for the construction, reconstruction and modernization of livestock farms (farms) | 1,383 | 8,684 | 10,067 |
| Subsidizing interest rates on loans by commercial banks, received a term of up to 8 years in the construction, reconstruction and modernization of industrial fish farming | – | 0,08 | 0,08 |
| Subsidization of the cost of paying interest on loans obtained for up to 5 years for the purchase of breeding livestock, machinery and equipment for livestock farms (farms) | 1,0 | 2,436 | 3,436 |
| Subsidizing interest rates on loans by commercial banks, received a term of up to 5 years for the purchase of breeding material, equipment and machinery for industrial fish farming | – | 0,04 | 0,04 |
| Subsidization of the cost of paying interest on loans obtained for up to 1 year in the Russian credit organizations | – | 4,178 | 4,178 |
| Grants to support the breeding of livestock | – | 1,325 | 1,325 |
| Grants to support the sheep | – | 0,3 | 0,3 |
| Grants to support: - the northern herd of reindeer herding and horse | – | 0,25 | 0,25 |
| Acquisition and transfer of leased machinery and equipment for livestock | 1,0 | 1,0 | 2,0 |
| Acquisition and transfer of leased highly breeding stock | 3,0 | 3,0 | 6,0 |
| **Total** | **6,383** | **21,293** | **27,676** |

# EFFECTIVE INTERNATIONAL EXPANSION STRATEGIES OF DEVELOPING COUNTRIES: SOME PRELIMINARY EVIDENCE FROM THE TURKISH MANUFACTURE AND EXPORT OF TELEVISION SETS

**Tanses Gülsoy**
**Beykent University, Istanbul, Turkey**[1]

**Özlem Özkanlı**
**Ankara University, Ankara, Turkey**

**Richard Lynch**
**Middlesex University, London, UK**

.

## ABSTRACT

*Over the last twenty years, Turkey has significantly increased its international trade in manufactured products. It is possible that this has been built on the basis of its lower labour costs compared with those of developed countries and the willingness of both Turkish national companies and Multi National Enterprises (MNEs) to invest in Turkey. While the basic evidence of Turkish trade development is clear, there has been only limited research on the business logic behind such growth, the reasons for choosing particular forms of expansion and the outcomes of such strategies at the present time for Turkish companies.*

*In order to explore these issues, we have undertaken a preliminary study of the Turkish manufacture and export of television set companies. Our findings show that companies have largely focused on European markets. We do not yet know the reasons for this but will investigate this in the next stage of our research. It is possible that our later research may provide some assistance both to individual companies and to Turkish national policy makers on future export development. However, our primary purpose will be to shed further light on the content and process by which developing countries pursue effective international expansion strategies.*

***Keywords:*** *Global strategy; Developing country strategy; Turkey export strategy; Turkish television set manufacture*

## INTRODUCTION

Over the last twenty years, Turkey has significantly increased its international trade in manufactured products: for example, merchandise exports measured in US dollars grew 284 per cent between years 2000 and 2007 (UNCTAD 2008). There is some evidence to suggest that this has primarily been built on the basis of its lower labour costs compared with those of developed countries and the willingness of both Turkish national companies and Multi National Enterprises (MNEs) to invest in Turkey (Dunning and Lundan 2008).

---

[1]For further information on this paper, contact: Tanses Gulsoy, Beykent University, Istanbul, Turkey: email: tansesgulsoy@beykent.edu.tr

We have chosen to focus on the Turkish electronics industry because it has had some success in recent years (TÜİK 2008a). The industry contains six sub-sectors: electronic components, consumer electronics, telecommunications equipment, computers, professional and industrial electronics equipment, and military electronics (DPT, 2007: 7). We have selected consumer electronics for our main research at this stage because it is the largest single sector within this category.

According to the Turkish State Planning Organization (DPT), the consumer electronics industry includes: all kinds of color televisions, audio devices, electronic scales, electronic calculators, video recorders, cash registers, audio/video cassettes, TV satellite receivers, and antenna stations (DPT, 2007: 121). However, the main driver of growth within consumer electronics has been television sets. We have therefore chosen at this stage in our research to focus on television manufacture, import and export. In 2007, Turkish television manufacturers commanded 55% of the European Union cathode-ray tube TV market (Turkish Ministry of Industry and Trade, 2008). In 2007 12.6 million sets were manufactured (TÜIK, 2008a), and that number was projected to reach 21 million sets by 2010 (DPT, 2007: 144). Television exports alone accounted for 1.9% of Turkey's total exports for 2007, revealing the strategic importance of the industry for Turkey's economy.

While the basic evidence of Turkish trade development is clear, there has been only limited research on the business logic behind such growth, the reasons for choosing particular forms of expansion and the outcomes of such strategies at the present time for Turkish companies. In turn, this relates to fundamental questions in international business literature: How do industries in developing countries like Turkey, China and India compete and sustain their growth over time? What are the key components of such international expansion strategies? To what extent are joint ventures, licensing and other forms of expansion important?

At the present time, there is only limited evidence on these broad and complex questions. We can find very few research papers at present on Turkish international expansion strategies. The purpose of this paper is to begin to address this issue. The new contribution of this paper is therefore to find the evidence and consider its implications for effective international expansion strategies of developing countries.

Our study explores Turkish television set manufacturers that have entered the global consumer electronics market after their well-established rivals. The reasons for choosing this product category are explored later in this paper. We draw on historic data for the shifting fortunes of other companies in the international consumer electronics industry to provide some strategic perspective. We then consider the following issues: How important have Turkish companies become? What are their prime sources of their international business at the present time? Why have they chosen particular strategies? And with what outcomes?

Specifically, this paper seeks to begin to address the following research questions:

1. How has Turkish television set manufacture grown over the last ten years? And with what results both internationally and domestically?
2. What strategies have Turkish companies used in their expansion? Specifically, what has been the role of pricing and innovation?
3. What are the managerial implications for effective international strategy development by developing countries?

We wish to emphasise that this paper represents a preliminary, exploratory study. We do not expect to obtain full answers to the above questions from this current paper.

## LITERATURE REVIEW AND RESEARCH FRAMEWORK

Although the literature in international business research is extensive and continues to grow (Werner, 2002), Axinn and Matthyssens (2002) have argued that most theories on international strategies focus on explaining the behaviour of large firms from developed countries. They do not provide the same insights into the behaviour of firms from developing nations in the international market place. Given the emergence of companies from new international trading nations like India, China and Turkey, the authors claim that it is imperative to look at new empirical evidence, rather than rely on existing theories of international trade.

Equally, Buckley (2002) commented that the entry of developing countries as major players in the global economy may give new impetus to such research. This is echoed by other scholars' calls for research into strategies for firms from emerging economies (Peng, 2005).

In view of the preliminary nature of the research developed in this paper, we have chosen to summarise the main strands of the literature in the table below. We make the assumption that readers will be broadly familiar with the relevant papers and focus on drawing out the main highlights.

With regard to our research framework, we have taken the view that the first stage in our research is to gather and review the existing data on Turkish business activity in our chosen sector. As a second stage, we would then expect to explore the reasons behind the data and thereby draw out some conclusions on effective international expansion by Turkish companies and its implications for effective international expansion strategy by developing countries. However, this latter part does not form part of this initial approach.

| Strategic issues | Some references |
|---|---|
| International business expansion | Dunning and Lundan 2008, Werner 2002; Axinn and Matthysens 2002; Buckley 2002, Johanson and Vahlne 1977 |
| Global strategy and related issues in regional strategy | Levitt, 1983; Douglas and Wind, 1987; Ghoshal, 1987; Yip, 1992; Dunning 1993; Dunning 1995; Ghemawat and Gaidar, 2000; Ghemawat 2003; Rugman and Verbeke 2003a, Rugman and Verbeke 2003b |
| Turkish international strategy – including routes to development | Taylan and Aari 2008, Ates 2006, Çakır, 2004, Karabati and Tan 2005 |
| Strategic process | Huff and Reger, 1987; Pettigrew, 1992; Papadakis and Barwise, 1997; Chakravarthy and White, 2002 – who identify four routes |
| Entry and expansion strategies of MNEs | Dunning and Lundan 2008, Delios and Henisz 2003, Forsgren 2002, Bartlett and Ghoshal 1989, Doz et al 2001 |
| Company resource management – international decisions and expansion | Doz 1986; Ohmae, 1983; Doz and Prahalad, 1991; Barney, 1991; Peteraf, 1993; Murtha et al 1998; Grant, 2002, Lynch 2008 |

# RESEARCH METHOD

At this early stage in our research, we have taken an eclectic approach to the gathering of data. We have been more concerned to see where the strands of information might lead us than to address specific hypotheses. Our approach has therefore been to examine the existing trade and company data in Turkey from an international development perspective.

The main data sources have been developed under the guidance and sponsorship of the Turkish Ministry of Industry and Trade (2008), the State Planning Organisation of Turkey DPT (2007), and the Istanbul Chamber of Industry (2001 and 2008). We have drawn heavily on these sources in our initial examination of the issues. However, some of this data has been summarised in reports prepared by the Turkish government and other official organisations and may therefore be subject to the opinions of those tasked with drawing up reports on Turkish international performance. To ensure that our data is accurate and not subject to interpretation bias, we have used the raw data from the relevant Turkish government offices in the compilation of our research rather than rely solely on the finished reports.

Initially we had some difficulty with the data from these sources but we have now resolved these problems. We are confident that our basic research information provides an adequate picture of the state of television production and international trade up to 2007. However, we would caution that the international trade downturn in 2009 is not reflected in our data set. Effective international development strategies may need to be reconsidered in this latter context over the period from 2010.

In addition to Turkish government official statistics, we have used the business press, personal contacts and other reports to develop as full a picture as possible at this stage of the Turkish television set industry, its role and strategies in international trade development.

# PRELIMINARY RESEARCH RESULTS

## Brief History of Consumer Electronics in Turkey

The Turkish electronics industry, considered Turkey's third biggest industry following textiles and construction, has had its beginnings in the early 1950s, in radio assembly manufacturing. This was followed by the manufacturing of telephone operating systems in the 1960s, and television manufacturing in 1968. In 1964, the government laid the groundwork for the establishment of a Turkish electronics industry by including a feasibility report in the First Five-Year Development Plan (Çakır, 2004: 4). In the second half of the 1960s, this time the start was given to the telecommunications industry. Therefore, mid-1960s can be said to have been critical years for the Turkish electronics industry.

The consumer electronics subindustry began to develop rapidly in the second half of the 1980s. Giving it fresh impetus was the beginning of investments in color broadcasting. Again during this decade the contribution of foreign direct investment made possible manufacturing in many different subindustries of electronics (Çakır, 2004: 5). Most Turkish companies began production through foreign license agreements, with the licensors originating from the Netherlands, Germany, Japan, USA, Canada, France, the UK, Denmark, and Italy (Sarı and Taylan, 2008: 1). The liberalization policies of the 1980s translated into increased productivity for consumer electronics manufacturers, who, as a result, increased their exports significantly (Çakır, 2004: 5). Today the industry can be said to have reached a significant level of technical proficiency.

## Turkey's Place in the World Television Set Industry

World television sales were estimated to be around 107 billion dollars in 2007 (Turkish Ministry of Industry and Trade, 2008). Asian countries' share in total production seems to continue increasing while that of Western Europe and the US decreases even if slightly (Çakır, 2004: 7). Japan is the world leader in color television manufacturing, followed by China and South Korea (ibid.). In the world market for television sets the biggest shares belong to Samsung (14%), LG (11%), Philips (7%), Sony (6%), and TCL (6%) (Turkish Ministry of Industry and Trade, 2008).

With exports of television sets estimated to be around 2.03 billion dollars in 2007 (TÜİK, 2008b), Turkey has a 1.9 % share in world television sales. Market share in Europe is estimated to be 40% (Turkish Ministry of Industry and Trade, 2008).

Prior to 1970, television manufacturing was vertically integrated; today, however, companies utilize external suppliers more and outsource manufacturing and design of components and products (Karabatı and Tan, 2005). During the 1990s, Turkey appeared as a low-cost manufacturing destination (ibid.). While Turkish manufacturers usually work as OEMs for manufacturers in Europe, by engaging in serious investments, some of them have turned into ODMs in time (DPT, 2007: 126).

Turkey captured the position of leading manufacturer in Europe in 1997 (Çakır, 2004: 11) and continues to maintain that position. The bulk of Turkish TV exports is composed of cathode-ray tube television sets (Please see Tables 4 and 5). Consumer gravitation away from CRT sets towards larger screen LCD and plasma sets is expected to grow exponentially (DPT, 2007: 129), and this trend is apparent in major markets such as the US, where CRT sets have already ceded leadership to flat panels (DuBravac, 2007).

## Production and Sales

Production of television sets in Turkey began in 1968, with a mere 1,532 sets (Çakır, 2004: 10). As television broadcasting spread in the 1970s, demand for television receivers rose. By 1971, production had increased nearly five-fold to 6,882 units (ibid.). Starting in 1972, imports decreased, and local manufacturers began to dominate the home market. Between 1968 and 1984 (the black-and-white television era), 1977 stands out as the year when black-and-white TV set production reached its peak (683,848 units) (ibid.). In 1984 color broadcasting began across the country, as a result of which demand for color television receivers climbed steeply. Color television production began in 1983, and starting in 1990, all of the television sets produced were color TVs (Usta, 2002: 14).

Factory sales of television sets for 25 years, between 1983-2007, are given in Table 1.

**Table 1: Television production in Turkey, 1983-2007**

| **Television Set Factory Sales in Turkey, 1983-2007** | | |
|---|---|---|
| Year | TOTAL FACTORY SALES (UNITS) | Rate of growth year on year |
| 1983 | 419.276 | |
| 1984 | 819.001 | 0,95 |
| 1985 | 1.016.616 | 0,24 |
| 1986 | 870.843 | -0,14 |
| 1987 | 690.187 | -0,21 |
| 1988 | 738.221 | 0,07 |
| 1989 | 999.264 | 0,35 |
| 1990 | 1.994.621 | 1,00 |
| 1991 | 2.567.773 | 0,29 |
| 1992 | 2.111.089 | -0,18 |
| 1993 | 1.921.704 | -0,09 |
| 1994 | 1.528.255 | -0,20 |
| 1995 | 1.859.333 | 0,22 |
| 1996 | 2.509.712 | 0,35 |
| 1997 | 4.657.007 | 0,86 |
| 1998 | 5.794.771 | 0,24 |
| 1999 | 6.941.004 | 0,20 |
| 2000 | 8.788.294 | 0,27 |
| 2001 | 8.025.118 | -0,09 |
| 2002 | 12.462.924 | 0,55 |
| 2003 | 15.035.590 | 0,21 |
| 2004 | 20.345.757 | 0,35 |
| 2005 | 20.790.123 | 0,02 |
| 2006 | 17.930.371 | -0,14 |
| 2007 | 12.591.569 | -0,30 |
| Total | 153.408.423 | |
| Source: TÜİK Turkish Statistics Institute, 2008a. | | |

The production of television sets follows to some extent economic vicissitudes, shrinking in recession years and rebounding once the economy becomes stronger. The economic recession of 1994 caused the contraction of the entire consumer electronics output in Turkey by 50% and forced the industry to seek overseas markets (Istanbul Chamber of Industry, 2001: 34). Consequently, between 1995 and 1999 the share of exports in total consumer electronics output exceeded 50% (ibid.).

Television set output, in the year 2000, increased by 27% compared to the previous year, reaching nearly 9 million sets (Please see Table 1). This was largely the result of the implementation of a fixed exchange rate policy, a relative decrease in interest rates, extension of consumer credit, and promotional campaigns, which stimulated demand (Çakır, 2004: 11). The growth trend, however, was disrupted with the severe recession experienced in 2001, and the industry's problems were further compounded with an anti-dumping investigation instigated by the EU in the year 2000 (Careful investigation of the costs of Turkish manufacturers later resulted in the dropping of anti-dumping charges against them). Consequently, output contracted by 9% from the previous year, and domestic sales fell by 44%. The industry managed to survive the recession by emphasizing export sales, thanks to which production rebounded the following year with a robust 55% increase (Please see Table 2). Between the year 2000 and 2006, the share of television exports in total television production consistently topped 80%, and frequently exceeded 90%.

**Table 2: Production, Exports, and Home Sales of TV Sets in Turkey, 1998-2007**

| TELEVISION SET PRODUCTION, EXPORTS, AND HOME SALES, 1998-2007 | | | | | |
|---|---|---|---|---|---|
| | PRODUCTION (Units) | EXPORTS (Units) | Share of Exports in Production | HOME SALES* (Units) | Share of Home Sales in Production |
| 1998 | 5.794.771 | 4.845.796 | 0,84 | 948.975 | 0,16 |
| 1999 | 6.941.004 | 5.425.734 | 0,78 | 1.515.270 | 0,22 |
| 2000 | 8.788.294 | 7.287.323 | 0,83 | 1.500.971 | 0,17 |
| 2001 | 8.025.118 | 6.978.610 | 0,87 | 1.046.508 | 0,13 |
| 2002 | 12.462.924 | 11.726.289 | 0,94 | 736.635 | 0,06 |
| 2003 | 15.035.590 | 14.836.697 | 0,99 | 198.893 | 0,01 |
| 2004 | 20.345.757 | 18.583.429 | 0,91 | 1.762.328 | 0,09 |
| 2005 | 20.790.123 | 16.942.529 | 0,81 | 3.847.594 | 0,19 |
| 2006 | 17.930.371 | 14.680.350 | 0,82 | 3.250.021 | 0,18 |
| 2007 | 12.591.569[a] | 8.708.505[a] | 0,69[a] | 3.883.064[a] | 0,31[a] |
| * Calculated from Production and Export figures. | | | | | |
| [a] Estimated figure. | | | | | |
| Source: TÜİK (2008a and 2008b). | | | | | |

It is hard to miss, however, the recent trend of decline in the year-on-year growth rate. As Europe constitutes the major export market of Turkish TVs, unfavorable economic developments in Europe as well as increasing competition in the European market seem to immediately result in repercussions for Turkish TV manufacturers. One of the reasons for the declining production may be the increasing consumer preference for LCD and plasma televisions in recent years. Another reason may be Turkish manufacturers' increasingly shifting their manufacturing operations abroad.

There are 326 firms operating in the industry of TV-radio receivers and audiovisual equipment, employing around 9,000 workers (Taylan and Sarı, 2008: 2). The main factories are located in Istanbul and Manisa (Taylan and Sarı, 2008: 2). The leading manufacturers of television sets are Arçelik-Beko (Beko Elektronik is now Grundig Elektronik, which merged entirely with Arçelik in late February of 2009), Vestel, and Profilo (Ministry of Industry and Trade, 2008).

## Television Exports

In consumer electronics exports, color TV tops the list, accounting for 94.4% of all industry exports in 2007 (TÜİK 2008b), and accounting for over 90% of all industry exports consistently since 1999 (Please see Table 3). In fact, since 1991 Turkey has enjoyed the position of net exporter of television sets.

Since 1990 manufacturers of consumer electronics in Europe have lost market share due to the high costs of labor and material (Çakır, 2004: 12). Turkish manufacturers have used the advantage of low labor costs to enter the European market. The application of anti-dumping restrictions against Far Eastern companies in mid-1990s provided an additional advantage for Turkish companies, which have been insulated from the competition of their Far Eastern rivals (ibid.). In recent years, this advantage seems to be eroding as Far

Eastern companies establish production centers in Europe in order to bypass anti-dumping regulations and customs barriers.

## Table 3: Turkey's Television Exports, 1998-2007

| Turkey's Exportation of Television Sets, 1998-2007 | | | | |
|---|---|---|---|---|
| | TV Exports | TV Exports | Total Consumer Electronics Exports | Share of TV exports in total consumer electronics |
| | (units) | (US dollars) | (US dollars) | |
| 1998 | 4.845.796 | 735.933.788 | 837.555.978 | 0,88 |
| 1999 | 5.425.734 | 674.894.281 | 736.649.395 | 0,92 |
| 2000 | 7.287.323 | 839.858.926 | 890.169.624 | 0,94 |
| 2001 | 6.978.610 | 864.986.214 | 921.778.005 | 0,94 |
| 2002 | 11.726.289 | 1.465.640.596 | 1.517.668.540 | 0,97 |
| 2003 | 14.836.697 | 1.820.244.134 | 1.908.326.713 | 0,95 |
| 2004 | 18.583.429 | 2.680.456.842 | 2.848.708.417 | 0,94 |
| 2005 | 16.942.529 | 2.933.948.995 | 3.130.934.434 | 0,94 |
| 2006 | 14.680.350 | 2.421.853.638 | 2.544.743.822 | 0,95 |
| 2007 | 8.708.505[a] | 2.025.390.007[a] | 2.144.759.796[a] | 0,94[a] |
| [a] Estimated figure. | | | | |
| * Source: TÜİK Turkish Statistics Institute, 2008b. | | | | |

In fact, investments in recent years have been directed towards the former Eastern Bloc countries such as Hungary, Poland, and the Czech Republic as well as to countries where cheap and quality labor is readily available (Çakır, 2004: 13). Special privileges granted by some governments in Europe to attract foreign direct investment have exacerbated competition (ibid.).

Export numbers, as growth in production, also indicate a declining trend in recent years. One of the reasons may be the appreciating Turkish lira. Another may be Turkish manufacturers' increasingly shifting their manufacturing facilities abroad. Yet another reason may be the growing consumer shift away from cathode-ray tube televisions, which constitute the bulk of Turkish television manufacturing, towards LCD and plasma sets.

Examination of exported television sets by type seems to confirm this trend (Please see Table 4). While television sets with a screen size smaller than 42 cm had a share of 40% among total television export shipments for 1998, their share has fallen to 28% in 2006 and 2007. The share of the television set category with a screen size above 52 centimeters and below 72 centimeters, on the other hand, jumped from 1% in 1999 to 46% in 2000, and in 2002 constituted 47% of total TV exports. In 2006 this category's share was 29% in total TV exports. Parallel with consumer trends, the above-72 cm screen CRT televisions have increased their share in TV exports consistently between 1998 and 2006, accounting for 4% of total TV shipments abroad in 2006 and 5% of total TV exports in value the same year.

## Table 4: Turkey's television exports by television type (units)

| TURKEY'S TELEVISION EXPORTS FOR 1998-2007 (Units) | | | | | | |
|---|---|---|---|---|---|---|
| | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** |
| CRT TV (screen diagonal<42 cm) | 1.952.360 | 2.274.311 | 2.732.193 | 2.169.596 | 3.586.782 | 4.167.003 |
| CRT TV (42 cm<screen diagonal <52 cm) | 946.468 | 1.125.803 | 1.511.677 | 1.253.942 | 1.888.235 | 1.973.792 |
| CRT TV (52 cm<screen diagonal <72 cm) | 1.909.079 | 1.921.015 | 2.803.359 | 3.213.177 | 5.505.734 | 6.167.973 |
| CRT TV (screen diagonal >72 cm) | 26.119 | 46.640 | 104.185 | 172.536 | 257.177 | 284.104 |
| CRT TV Subtotal | **4.834.026** | **5.367.769** | **7.151.414** | **6.809.251** | **11.237.928** | **12.592.872** |
| CRT TV Other | 1.301 | 12.755 | 59.720 | 94.723 | 175.490 | 468.267 |
| CRT TV Total | **4.835.327** | **5.380.524** | **7.211.134** | **6.903.974** | **11.413.418** | **13.061.139** |
| Combined TV | 4.731 | 1.851 | 1.760 | 9.894 | 238.841 | 709.321 |
| Video tuners with screen and others | 392 | 2.662 | 2.740 | 35 | 4.231 | 887.807 |
| Other TV | 5.346 | 40.697 | 71.689 | 64.707 | 69.799 | 178.430 |
| TV TOTAL* | **4.845.796** | **5.425.734** | **7.287.323** | **6.978.610** | **11.726.289** | **14.836.697** |
| Total Consumer Electronics | **4.916.955** | **5.514.070** | **7.392.675** | **7.148.101** | **35.096.933** | **71.829.001** |
| | | | | | | |
| | **2004** | **2005** | **2006** | | | **2007**** |
| CRT TV (screen diagonal<42 cm) | 4.880.936 | 4.212.850 | 4.124.177 | CRT TV (screen diagonal<42 cm) | | 2.473.404 |
| CRT TV (42 cm<screen diagonal <52 cm) | 2.259.137 | 1.676.881 | 1.749.455 | CRT TV (42 cm<screen diagonal <52 cm) | | |
| CRT TV (52 cm<screen diagonal <72 cm) | 6.439.098 | 5.322.690 | 4.303.697 | CRT TV (52 cm<screen diagonal <72 cm) | | 1.125.762 |
| CRT TV (screen diagonal >72 cm) | 483.329 | 528.360 | 649.882 | CRT TV (screen diagonal >72 cm) | | 48.448 |
| CRT TV Subtotal | **14.062.500** | **11.740.781** | **10.827.211** | CRT TV Subtotal | | **3.647.614** |
| CRT TV Other | 1.095.520 | 822.390 | 486.979 | CRT TV Other*** | | |
| CRT TV Total | **15.158.020** | **12.563.171** | **11.314.190** | CRT TV Total | | **3.647.614** |
| Combined TV | 2.060.656 | 1.238.159 | 1.007.722 | Plasma TV*** | | |
| Video tuners with screen and others | 791.076 | 2.347.339 | 1.899.632 | LCD TV | | 4.331.682 |
| Other TV | 573.677 | 793.860 | 458.806 | Other TV | | 729.209 |
| TV TOTAL* | **18.583.429** | **16.942.529** | **14.680.350** | TV TOTAL* | | **8.708.505** |
| Total Consumer Electronics | **70.388.814** | **65.398.984** | **21.204.977** | Total Consumer Electronics | | **45.103.024** |

* The customs tariff position number "85-28" includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in "Other TV" and hence 'TV TOTAL".

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

## Table 5: Turkey's television exports by television type (US dollars)

| TURKEY'S TELEVISION EXPORTS FOR 1998-2007 (US Dollars) | | | | | | |
|---|---|---|---|---|---|---|
| | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** |
| CRT TV (screen diagonal<42 cm) | 204.478.796 | 197.760.623 | 224.046.150 | 172.871.519 | 259.705.693 | 307.378.741 |
| CRT TV (42 cm<screen diagonal <52 cm) | 129.532.497 | 127.159.027 | 151.183.617 | 124.153.239 | 173.710.558 | 202.483.561 |
| CRT TV (52 cm<screen diagonal <72 cm) | 387.768.643 | 324.979.285 | 413.146.267 | 480.970.619 | 826.486.874 | 898.833.102 |
| CRT TV (screen diagonal >72 cm) | 13.018.676 | 16.103.822 | 27.250.205 | 46.522.459 | 74.721.655 | 88.109.661 |
| CRT TV Subtotal | **734.798.612** | **666.002.757** | **815.626.239** | **824.517.836** | **1.334.624.780** | **1.496.805.065** |
| CRT TV Other | 329.660 | 4.727.409 | 20.550.096 | 35.657.764 | 69.629.489 | 142.366.616 |
| CRT TV Total | 735.128.272 | 670.730.166 | 836.176.335 | 860.175.600 | 1.404.254.269 | 1.639.171.681 |
| Combined TV | 174.580 | 183.515 | 266.322 | 2.067.893 | 52.686.504 | 103.493.453 |
| Video tuners with screen and others | 189.154 | 299.668 | 320.087 | 51.751 | 1.365.788 | 22.052.121 |
| Other TV | 441.782 | 3.680.932 | 3.096.182 | 2.690.970 | 7.334.035 | 55.526.879 |
| TV TOTAL* | **735.933.788** | **674.894.281** | **839.858.926** | **864.986.214** | **1.465.640.596** | **1.820.244.134** |
| Total Consumer Electronics | **837.555.978** | **736.649.395** | **890.169.624** | **921.778.005** | **1.517.668.540** | **1.908.326.713** |
| | | | | | | |
| | **2004** | **2005** | **2006** | | | **2007**** |
| CRT TV (screen diagonal<42 cm) | 341.919.266 | 255.832.067 | 244.945.696 | CRT TV (screen diagonal<42 cm) | | 153.098.427 |
| CRT TV (42 cm<screen diagonal <52 cm) | 237.410.756 | 137.217.447 | 140.764.025 | CRT TV (42 cm<screen diagonal <52 cm) | | |
| CRT TV (52 cm<screen diagonal <72 cm) | 932.144.428 | 603.153.852 | 474.299.719 | CRT TV (52 cm<screen diagonal <72 cm) | | 158.795.809 |
| CRT TV (screen diagonal >72 cm) | 128.984.957 | 110.263.774 | 119.259.210 | CRT TV (screen diagonal >72 cm) | | 9.799.965 |
| CRT TV Subtotal | **1.640.459.407** | **1.106.467.140** | **979.268.650** | CRT TV Subtotal | | **321.694.201** |
| CRT TV Other | 290.330.704 | 180.491.360 | 103.952.241 | CRT TV Other*** | | |
| CRT TV Total | 1.930.790.111 | 1.286.958.500 | 1.083.220.891 | CRT TV Total | | 321.694.201 |
| Combined TV | 182.193.457 | 141.802.774 | 110.611.827 | Plasma TV*** | | |
| Video tuners with screen and others | 501.406.649 | 1.336.441.842 | 1.206.770.624 | LCD TV | | 1.667.533.396 |
| Other TV | 66.066.625 | 168.745.879 | 21.250.296 | Other TV | | 36.162.410 |
| TV TOTAL* | **2.680.456.842** | **2.933.948.995** | **2.421.853.638** | TV TOTAL* | | **2.025.390.007** |
| Total Consumer Electronics | **2.848.708.417** | **3.130.934.434** | **2.544.743.822** | Total Consumer Electronics | | **2.144.759.796** |

* The customs tariff position number "85-28" includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in "Other TV" and hence 'TV TOTAL".

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

Declining TV prices is a well-known phenomenon around the world, and this trend can easily be seen in the mean unit prices of Turkish TV exports and imports across the years.

# Table 6: Mean unit prices of TV export items, 1998-2003

| MEAN UNIT PRICES OF TV EXPORT ITEMS, 1998-2003 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| EXPORT ITEM | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
| | **1998** | **1998** | **1998** | **1999** | **1999** | **1999** | **2000** | **2000** | **2000** |
| CRT TV (screen diagonal<42 cm) | 1.952.360 | 204.478.796 | 104,73 | 2.274.311 | 197.760.623 | 86,95 | 2.732.193 | 224.046.150 | 82,00 |
| CRT TV (42 cm<screen diagonal <52 cm) | 946.468 | 129.532.497 | 136,86 | 1.125.803 | 127.159.027 | 112,95 | 1.511.677 | 151.183.617 | 100,01 |
| CRT TV (52 cm<screen diagonal <72 cm) | 1.909.079 | 387.768.643 | 203,12 | 1.921.015 | 324.979.285 | 169,17 | 2.803.359 | 413.146.267 | 147,38 |
| CRT TV (screen diagonal >72 cm) | 26.119 | 13.018.676 | 498,44 | 46.640 | 16.103.822 | 345,28 | 104.185 | 27.250.205 | 261,56 |
| CRT TV Subtotal | **4.834.026** | **734.798.612** | 152,01 | **5.367.769** | **666.002.757** | 124,07 | **7.151.414** | **815.626.239** | 114,05 |
| CRT TV Other | 1.301 | 329.660 | 253,39 | 12.755 | 4.727.409 | 370,63 | 59.720 | 20.550.096 | 344,11 |
| CRT TV Total | **4.835.327** | 735.128.272 | 152,03 | **5.380.524** | 670.730.166 | 124,66 | **7.211.134** | 836.176.335 | 115,96 |
| Combined TV | 4.731 | 174.580 | 36,90 | 1.851 | 183.515 | 99,14 | 1.760 | 266.322 | 151,32 |
| Video tuners with screen, etc. | 392 | 189.154 | 482,54 | 2.662 | 299.668 | 112,57 | 2.740 | 320.087 | 116,82 |
| Other TV | 5.346 | 441.782 | 82,64 | 40.697 | 3.680.932 | 90,45 | 71.689 | 3.096.182 | 43,19 |
| TV TOTAL* | **4.845.796** | **735.933.788** | 151,87 | **5.425.734** | **674.894.281** | 124,39 | **7.287.323** | **839.858.926** | 115,25 |
| Total Consumer Electronics | **4.916.955** | **837.555.978** | | **5.514.070** | **736.649.395** | | **7.392.675** | **890.169.624** | |
| | | | | | | | | | |
| EXPORT ITEM | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
| | **2001** | **2001** | **2001** | **2002** | **2002** | **2002** | **2003** | **2003** | **2003** |
| CRT TV (screen diagonal<42 cm) | 2.169.596 | 172.871.519 | 79,68 | 3.586.782 | 259.705.693 | 72,41 | 4.167.003 | 307.378.741 | 73,76 |
| CRT TV (42 cm<screen diagonal <52 cm) | 1.253.942 | 124.153.239 | 99,01 | 1.888.235 | 173.710.558 | 92,00 | 1.973.792 | 202.483.561 | 102,59 |
| CRT TV (52 cm<screen diagonal <72 cm) | 3.213.177 | 480.970.619 | 149,69 | 5.505.734 | 826.486.874 | 150,11 | 6.167.973 | 898.833.102 | 145,73 |
| CRT TV (screen diagonal >72 cm) | 172.536 | 46.522.459 | 269,64 | 257.177 | 74.721.655 | 290,55 | 284.104 | 88.109.661 | 310,13 |
| CRT TV Subtotal | **6.809.251** | **824.517.836** | 121,09 | **11.237.928** | **1.334.624.780** | 118,76 | **12.592.872** | **1.496.805.065** | 118,86 |
| CRT TV Other | 94.723 | 35.657.764 | 376,44 | 175.490 | 69.629.489 | 396,77 | 468.267 | 142.366.616 | 304,03 |
| CRT TV TOTAL | **6.903.974** | 860.175.600 | 124,59 | **11.413.418** | 1.404.254.269 | 123,04 | **13.061.139** | 1.639.171.681 | 125,50 |
| COMBINED TV | 9.894 | 2.067.893 | 209,00 | 238.841 | 52.686.504 | 220,59 | 709.321 | 103.493.453 | 145,90 |
| VIDEO TUNERS WITH SCREEN and others | 35 | 51.751 | 1.478,60 | 4.231 | 1.365.788 | 322,81 | 887.807 | 22.052.121 | 24,84 |
| Other TV | 64.707 | 2.690.970 | 41,59 | 69.799 | 7.334.035 | 105,07 | 178.430 | 55.526.879 | 311,20 |
| **TV Total*** | **6.978.610** | **864.986.214** | 123,95 | **11.726.289** | **1.465.640.596** | 124,99 | **14.836.697** | **1.820.244.134** | 122,69 |
| Total Consumer Electronics | **7.148.101** | **921.778.005** | | **35.096.933** | **1.517.668.540** | | **71.829.001** | **1.908.326.713** | |

* The customs tariff position number "85-28" includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in "Other TV" and hence 'TV TOTAL".

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

## Table 7: Mean unit prices of TV export items, 2004-2007

| MEAN UNIT PRICES OF TV EXPORT ITEMS, 2004-2007 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| EXPORT ITEM | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
| | **2004** | **2004** | **2004** | **2005** | **2005** | **2005** | **2006** | **2006** | **2006** |
| CRT TV (screen diagonal< 42 cm) | 4.880.936 | 341.919.266 | 70,05 | 4.212.850 | 255.832.067 | 60,73 | 4.124.177 | 244.945.696 | 59,39 |
| CRT TV (42 cm<screen diagonal <52 cm) | 2.259.137 | 237.410.756 | 105,09 | 1.676.881 | 137.217.447 | 81,83 | 1.749.455 | 140.764.025 | 80,46 |
| CRT TV (52 cm<screen diagonal <72 cm) | 6.439.098 | 932.144.428 | 144,76 | 5.322.690 | 603.153.852 | 113,32 | 4.303.697 | 474.299.719 | 110,21 |
| CRT TV (screen diagonal >72 cm) | 483.329 | 128.984.957 | 266,87 | 528.360 | 110.263.774 | 208,69 | 649.882 | 119.259.210 | 183,51 |
| CRT TV Subtotal | **14.062.500** | **1.640.459.407** | 116,65 | **11.740.781** | **1.106.467.140** | 94,24 | **10.827.211** | **979.268.650** | 90,45 |
| CRT TV Other | 1.095.520 | 290.330.704 | 265,02 | 822.390 | 180.491.360 | 219,47 | 486.979 | 103.952.241 | 213,46 |
| CRT TV Total | **15.158.020** | 1.930.790.111 | 127,38 | **12.563.171** | 1.286.958.500 | 102,44 | **11.314.190** | 1.083.220.891 | 95,74 |
| Combined TV | 2.060.656 | 182.193.457 | 88,42 | 1.238.159 | 141.802.774 | 114,53 | 1.007.722 | 110.611.827 | 109,76 |
| Video tuners with screen, etc. | 791.076 | 501.406.649 | 633,83 | 2.347.339 | 1.336.441.842 | 569,34 | 1.899.632 | 1.206.770.624 | 635,27 |
| Other TV | 573.677 | 66.066.625 | 115,16 | 793.860 | 168.745.879 | 212,56 | 458.806 | 21.250.296 | 46,32 |
| TV TOTAL* | **18.583.429** | **2.680.456.842** | 144,24 | **16.942.529** | **2.933.948.995** | 173,17 | **14.680.350** | **2.421.853.638** | 164,97 |
| Total Consumer Electronics | **70.388.814** | **2.848.708.417** | | **65.398.984** | **3.130.934.434** | | **21.204.977** | **2.544.743.822** | |

| Export Item | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
|---|---|---|---|
| | **2007**** | **2007**** | **2007**** |
| CRT TV (screen diagonal<42 cm) | 2.473.404 | 153.098.427 | 61,90 |
| CRT TV (42 cm<screen diagonal <52 cm) | | | |
| CRT TV (52 cm<screen diagonal <72 cm) | 1.125.762 | 158.795.809 | 141,06 |
| CRT TV (screen diagonal >72 cm) | 48.448 | 9.799.965 | 202,28 |
| CRT TV Subtotal | **3.647.614** | **321.694.201** | 88,19 |
| CRT TV Other*** | | | |
| CRT TV Total | **3.647.614** | 321.694.201 | 88,19 |
| Plasma TV*** | | | |
| LCD TV | 4.331.682 | 1.667.533.396 | 384,96 |
| Other TV | 729.209 | 36.162.410 | 49,59 |
| TV TOTAL* | **8.708.505** | **2.025.390.007** | 232,58 |
| Total Consumer Electronics | **45.103.024,00** | **2.144.759.796** | |

* The customs tariff position number “85-28” includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in “Other TV” and hence ‘TV TOTAL”.

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

Color televisions made in Turkey have a good reputation among European consumers with respect to price and quality. Turkish manufacturers follow European and international standards and norms, and since 2002, production carries the “CE” mark (Taylan and Sarı, 2008: 3).

The European Union is Turkey’s biggest trading partner; in 2006, Turkey received 4.3% of all EU exports, and 3.1% of all EU imports that year were accounted for by Turkey (Eurostat, 2007: 57). In 2005, Turkey’s global exports were valued at 58.8 billion Euros, 56% of which were destined to the EU-27; and that same year a share of 45% of imports to Turkey was accounted for by the EU-27.

Of total television exports, 91% are headed to ten member states of the European Union (DTM, 2006: 6). For television sets, the UK has been the biggest export market for the past two years, followed by Germany, Spain, France, the Netherlands, and Italy. Of total television exports for 2007, for instance, the UK accounted for 32%, Germany for 20%, Spain for 10%, France for 9%, the Netherlands for 5%, and Italy for 4% (DTM, 2006: 8).

Today Turkish producers command 25% of the European color TV market (Önkol, 2008), and Turkey appears to be the television factory of Europe. The second biggest market for color TVs after the European Union is the Russian Federation and the Turkic republics (Çakır, 2004).

## Television Imports

Electronic components production in Turkey is limited, and especially some of the components used in the manufacturing of television sets are largely imported (Çakır, 2004: 16). It is sometimes more cost-effective for Turkish manufacturers to import finished goods, especially from China, South Korea, and Hong Kong (ibid.). Turkey's television imports over the past ten years, therefore, follow a generally increasing trend, with occasional dips such as in the recession year of 2001 (Please see Table 8).

Between 2005 and 2006, for instance, TV imports rose by 22% in value, from US$221,869,314 to US$270,773,182. Television sets is an area, however, where Turkey has a favorable trade balance. Between 2002 and 2005, the export/import ratio has exceeded 1,300% (reaching its peak of 1,612% in 2002).

**Table 8: Turkey's television exports and imports, 1998-2007**

| TURKEY'S TELEVISION EXPORTS AND IMPORTS, 1998-2007 | | | |
|---|---|---|---|
| YEAR | EXPORTS | IMPORTS | EXPORT/IMPORT RATIO |
| | (US Dollars) | (US Dollars) | % |
| 1998 | 735.933.788 | 93.254.438 | 789,17 |
| 1999 | 674.894.281 | 113.123.599 | 596,60 |
| 2000 | 839.858.926 | 178.476.868 | 470,57 |
| 2001 | 864.986.214 | 97.090.684 | 890,91 |
| 2002 | 1.465.640.596 | 90.920.719 | 1.612,00 |
| 2003 | 1.820.244.134 | 119.425.348 | 1.524,17 |
| 2004 | 2.680.456.842 | 193.849.072 | 1.382,75 |
| 2005 | 2.933.948.995 | 221.869.314 | 1.322,38 |
| 2006 | 2.421.853.638 | 270.773.182 | 894,42 |
| 2007 | 2.025.390.007[a] | 760.191.838[a] | 266,43[a] |
| [a] The figures for 2007 are provisional, and according to the legislation pertaining to data confidentiality, data for some of the categories have not been released. | | | |
| Source: TÜİK (Turkish Statistics Institute), 2008b. | | | |

The consumer shift away from cathode-ray televisions towards LCD and plasma televisions can be clearly seen from the import figures of recent years (Please see Table 9). While the share of CRT televisions in total television imports was 41% in 1998, by 2006 that figure has fallen to 9% in unit terms. In dollar terms, that corresponds to a decline from 69% to 6%.

## Table 9: Turkey's television imports, 1998-2007 (Units)

| TURKEY'S TELEVISION IMPORTS FOR 1998-2007 (Units) | | | | | | |
|---|---|---|---|---|---|---|
| | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** |
| CRT TV (screen diagonal<42 cm) | 118.008 | 230.252 | 193.538 | 64.252 | 118.496 | 228.850 |
| CRT TV (42 cm<screen diagonal <52 cm) | 83.938 | 67.039 | 68.029 | 23.928 | 16.831 | 10.591 |
| CRT TV (52 cm<screen diagonal <72 cm) | 97.719 | 137.014 | 186.605 | 50.948 | 127.583 | 112.361 |
| CRT TV (screen diagonal >72 cm) | 9.953 | 10.501 | 38.514 | 25.696 | 45.675 | 57.180 |
| CRT TV Subtotal | **309.618** | **444.806** | **486.686** | **164.824** | **308.585** | **408.982** |
| CRT TV Other | 2.894 | 2.036 | 8.545 | 3.274 | 5.015 | 7.131 |
| CRT TV Total | **312.512** | **446.842** | **495.231** | **168.098** | **313.600** | **416.113** |
| Combined TV | 2.757 | 2.152 | 5.239 | 710 | 4.585 | 5.160 |
| Video tuners with screen and others | 1.500 | 603 | 3.069 | 5.203 | 4.613 | 9.297 |
| Other TV | 440.270 | 607.971 | 873.243 | 486.149 | 380.596 | 779.093 |
| TV TOTAL* | **757.039** | **1.057.568** | **1.376.782** | **660.160** | **703.394** | **1.209.663** |
| Total Consumer Electronics | **8.253.458** | **8.347.346** | **10.582.498** | **4.793.957** | **88.696.142** | **89.175.735** |
| | | | | | | |
| | **2004** | **2005** | **2006** | | | **2007**** |
| CRT TV (screen diagonal<42 cm) | 93.205 | 22.840 | 4.185 | CRT TV (screen diagonal<42 cm) | | 8.239 |
| CRT TV (42 cm<screen diagonal <52 cm) | 6.988 | 4.060 | 1.930 | CRT TV (42 cm<screen diagonal <52 cm) | | 98 |
| CRT TV (52 cm<screen diagonal <72 cm) | 70.812 | 65.226 | 29.546 | CRT TV (52 cm<screen diagonal <72 cm) | | 17.321 |
| CRT TV (screen diagonal >72 cm) | 86.205 | 56.574 | 21.867 | CRT TV (screen diagonal >72 cm) | | 6.984 |
| CRT TV Subtotal | **257.210** | **148.700** | **57.528** | CRT TV Subtotal | | **32.642** |
| CRT TV Other | 22.981 | 17.442 | 6.926 | CRT TV Other*** | | 96 |
| CRT TV Total | **280.191** | **166.142** | **64.454** | CRT TV Total | | **32.738** |
| Combined TV | 4.068 | 3.912 | 3.381 | Plasma TV*** | | 49.577 |
| Video tuners with screen and others | 24.051 | 67.968 | 140.890 | LCD TV | | 266.647 |
| Other TV | 2.035.953 | 1.368.152 | 476.109 | Other TV | | 3.278.167 |
| TV TOTAL* | **2.344.263** | **1.606.174** | **684.834** | TV TOTAL* | | **3.627.129** |
| Total Consumer Electronics | **164.265.132** | **119.422.618** | **85.504.889** | Total Consumer Electronics | | **601.478.514** |

***** The customs tariff position number "85-28" includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in "Other TV" and hence 'TV TOTAL".

****** The 2007 figures are provisional.

******* According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

In television set imports, as in exports, European Union countries top the list. They are followed by Japan and other countries in the Far East.

## Table 10: Turkey’s television imports, 1998-2007 (US dollars)

**TURKEY’S TELEVISION IMPORTS FOR 1998-2007 (US Dollars)**

| | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** |
|---|---|---|---|---|---|---|
| CRT TV (screen diagonal<42 cm) | 14.930.651 | 16.384.207 | 13.983.065 | 4.765.841 | 5.170.565 | 8.844.754 |
| CRT TV (42 cm<screen diagonal <52 cm) | 15.933.906 | 10.216.121 | 7.910.909 | 2.525.023 | 1.513.993 | 1.076.977 |
| CRT TV (52 cm<screen diagonal <72 cm) | 26.830.377 | 31.042.533 | 33.744.650 | 8.951.770 | 18.866.235 | 12.430.314 |
| CRT TV (screen diagonal >72 cm) | 4.913.089 | 4.809.236 | 16.528.004 | 10.311.331 | 17.285.061 | 18.385.039 |
| CRT TV Subtotal | **62.608.023** | **62.452.097** | **72.166.628** | **26.553.965** | **42.835.854** | **40.737.084** |
| CRT TV Other | 2.091.768 | 1.550.825 | 5.626.636 | 3.250.298 | 3.900.127 | 3.894.089 |
| CRT TV Total | **64.699.791** | **64.002.922** | **77.793.264** | **29.804.263** | **46.735.981** | **44.631.173** |
| Combined TV | 1.275.659 | 2.026.860 | 586.643 | 237.971 | 1.094.724 | 1.087.717 |
| Video tuners with screen and others | 606.870 | 738.191 | 1.787.472 | 838.087 | 3.248.612 | 4.748.184 |
| Other TV | 26.672.118 | 46.355.626 | 98.309.489 | 66.210.363 | 39.841.402 | 68.958.274 |
| TV TOTAL* | **93.254.438** | **113.123.599** | **178.476.868** | **97.090.684** | **90.920.719** | **119.425.348** |
| Total Consumer Electronics | **727.801.585** | **820.586.292** | **1.104.333.968** | **660.796.026** | **713.971.436** | **974.117.243** |

| | **2004** | **2005** | **2006** | | **2007**** |
|---|---|---|---|---|---|
| CRT TV (screen diagonal<42 cm) | 4.414.435 | 1.751.570 | 531.198 | CRT TV (screen diagonal<42 cm) | 866.122 |
| CRT TV (42 cm<screen diagonal <52 cm) | 1.741.538 | 750.539 | 917.613 | CRT TV (42 cm<screen diagonal <52 cm) | 26.927 |
| CRT TV (52 cm<screen diagonal <72 cm) | 10.187.620 | 12.523.501 | 5.561.619 | CRT TV (52 cm<screen diagonal <72 cm) | 4.466.837 |
| CRT TV (screen diagonal >72 cm) | 25.558.285 | 20.786.425 | 7.800.834 | CRT TV (screen diagonal >72 cm) | 2.063.233 |
| CRT TV Subtotal | **41.901.878** | **35.812.035** | **14.811.264** | CRT TV Subtotal | **7.423.119** |
| CRT TV Other | 16.360.986 | 13.155.183 | 2.406.060 | CRT TV Other*** | 58.945 |
| CRT TV Total | **58.262.864** | **48.967.218** | **17.217.324** | CRT TV Total | **7.482.064** |
| Combined TV | 1.165.243 | 837.705 | 500.515 | Plasma TV*** | 56.545.213 |
| Video tuners with screen and others | 11.472.755 | 43.600.421 | 119.337.130 | LCD TV | 204.778.807 |
| Other TV | 122.948.210 | 128.463.970 | 133.718.213 | Other TV | 491.385.754 |
| TV TOTAL* | **193.849.072** | **221.869.314** | **270.773.182** | TV TOTAL* | **760.191.838** |
| Total Consumer Electronics | **1.411.252.891** | **1.748.426.402** | **1.684.235.771** | Total Consumer Electronics | **2.216.683.435** |

* The customs tariff position number “85-28” includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in “Other TV” and hence ‘TV TOTAL”.

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

# Table 11: Mean unit prices of TV import items, 1998-2003

| MEAN UNIT PRICES OF TV IMPORT ITEMS, 1998-2003 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| IMPORT ITEM | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
| | **1998** | **1998** | **1998** | **1999** | **1999** | **1999** | **2000** | **2000** | **2000** |
| CRT TV (screen diagonal<42 cm) | 118.008 | 14.930.651 | 126,52 | 230.252 | 16.384.207 | 71,16 | 193.538 | 13.983.065 | 72,25 |
| CRT TV (42 cm<screen diagonal <52 cm) | 83.938 | 15.933.906 | 189,83 | 67.039 | 10.216.121 | 152,39 | 68.029 | 7.910.909 | 116,29 |
| CRT TV (52 cm<screen diagonal <72 cm) | 97.719 | 26.830.377 | 274,57 | 137.014 | 31.042.533 | 226,56 | 186.605 | 33.744.650 | 180,83 |
| CRT TV (screen diagonal >72 cm) | 9.953 | 4.913.089 | 493,63 | 10.501 | 4.809.236 | 457,98 | 38.514 | 16.528.004 | 429,14 |
| CRT TV Subtotal | **309.618** | **62.608.023** | 202,21 | **444.806** | **62.452.097** | 140,40 | **486.686** | **72.166.628** | 148,28 |
| CRT TV Other | 2.894 | 2.091.768 | 722,79 | 2.036 | 1.550.825 | 761,70 | 8.545 | 5.626.636 | 658,47 |
| CRT TV Total | **312.512** | **64.699.791** | 207,03 | **446.842** | **64.002.922** | 143,23 | **495.231** | **77.793.264** | 157,08 |
| Combined TV | 2.757 | 1.275.659 | 462,70 | 2.152 | 2.026.860 | 941,85 | 5.239 | 586.643 | 111,98 |
| Video tuners with screen, etc. | 1.500 | 606.870 | 404,58 | 603 | 738.191 | 1.224,20 | 3.069 | 1.787.472 | 582,43 |
| Other TV | 440.270 | 26.672.118 | 60,58 | 607.971 | 46.355.626 | 76,25 | 873.243 | 98.309.489 | 112,58 |
| TV TOTAL* | **757.039** | **93.254.438** | 123,18 | **1.057.568** | **113.123.599** | 106,97 | **1.376.782** | **178.476.868** | 129,63 |
| Total Consumer Electronics | **8.253.458** | **727.801.585** | | **8.347.346** | **820.586.292** | | **10.582.498** | **1.104.333.968** | |
| | | | | | | | | | |
| IMPORT ITEM | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
| | **2001** | **2001** | **2001** | **2002** | **2002** | **2002** | **2003** | **2003** | **2003** |
| CRT TV (screen diagonal<42 cm) | 64.252 | 4.765.841 | 74,17 | 118.496 | 5.170.565 | 43,63 | 228.850 | 8.844.754 | 38,65 |
| CRT TV (42 cm<screen diagonal <52 cm) | 23.928 | 2.525.023 | 105,53 | 16.831 | 1.513.993 | 89,95 | 10.591 | 1.076.977 | 101,69 |
| CRT TV (52 cm<screen diagonal <72 cm) | 50.948 | 8.951.770 | 175,70 | 127.583 | 18.866.235 | 147,87 | 112.361 | 12.430.314 | 110,63 |
| CRT TV (screen diagonal >72 cm) | 25.696 | 10.311.331 | 401,28 | 45.675 | 17.285.061 | 378,44 | 57.180 | 18.385.039 | 321,53 |
| CRT TV Subtotal | **164.824** | **26.553.965** | 161,10 | **308.585** | **42.835.854** | 138,81 | **408.982** | **40.737.084** | 99,61 |
| CRT TV Other | 3.274 | 3.250.298 | 992,76 | 5.015 | 3.900.127 | 777,69 | 7.131 | 3.894.089 | 546,08 |
| CRT TV TOTAL | **168.098** | **29.804.263** | 177,30 | **313.600** | **46.735.981** | 149,03 | **416.113** | **44.631.173** | 107,26 |
| COMBINED TV | 710 | 237.971 | 335,17 | 4.585 | 1.094.724 | 238,76 | 5.160 | 1.087.717 | 210,80 |
| VIDEO TUNERS WITH SCREEN and others | 5.203 | 838.087 | 161,08 | 4.613 | 3.248.612 | 704,23 | 9.297 | 4.748.184 | 510,72 |
| Other TV | 486.149 | 66.210.363 | 136,19 | 380.596 | 39.841.402 | 104,68 | 779.093 | 68.958.274 | 88,51 |
| **TV Total*** | **660.160** | **97.090.684** | 147,07 | **703.394** | **90.920.719** | 129,26 | **1.209.663** | **119.425.348** | 98,73 |
| Total Consumer Electronics | **4.793.957** | **660.796.026** | | **88.696.142** | **713.971.436** | | **89.175.735** | **974.117.243** | |

* The customs tariff position number "85-28" includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in "Other TV" and hence 'TV TOTAL".

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

# Table 12: Mean unit prices of TV import items, 2004-2007

| MEAN UNIT PRICES OF TV IMPORT ITEMS, 2004-2007 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| IMPORT ITEM | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
| | **2004** | **2004** | **2004** | **2005** | **2005** | **2005** | **2006** | **2006** | **2006** |
| CRT TV (screen diagonal<42 cm) | 93.205 | 4.414.435 | 47,36 | 22.840 | 1.751.570 | 76,69 | 4.185 | 531.198 | 126,93 |
| CRT TV (42 cm<screen diagonal <52 cm) | 6.988 | 1.741.538 | 249,22 | 4.060 | 750.539 | 184,86 | 1.930 | 917.613 | 475,45 |
| CRT TV (52 cm<screen diagonal <72 cm) | 70.812 | 10.187.620 | 143,87 | 65.226 | 12.523.501 | 192,00 | 29.546 | 5.561.619 | 188,24 |
| CRT TV (screen diagonal >72 cm) | 86.205 | 25.558.285 | 296,48 | 56.574 | 20.786.425 | 367,42 | 21.867 | 7.800.834 | 356,74 |
| CRT TV Subtotal | **257.210** | **41.901.878** | 162,91 | **148.700** | **35.812.035** | 240,83 | **57.528** | **14.811.264** | 257,46 |
| CRT TV Other | 22.981 | 16.360.986 | 711,94 | 17.442 | 13.155.183 | 754,22 | 6.926 | 2.406.060 | 347,40 |
| CRT TV Total | **280.191** | **58.262.864** | 207,94 | **166.142** | **48.967.218** | 294,73 | **64.454** | **17.217.324** | 267,13 |
| Combined TV | 4.068 | 1.165.243 | 286,44 | 3.912 | 837.705 | 214,14 | 3.381 | 500.515 | 148,04 |
| Video tuners with screen, etc. | 24.051 | 11.472.755 | 477,02 | 67.968 | 43.600.421 | 641,48 | 140.890 | 119.337.130 | 847,02 |
| Other TV | 2.035.953 | 122.948.210 | 60,39 | 1.368.152 | 128.463.970 | 93,90 | 476.109 | 133.718.213 | 280,86 |
| TV TOTAL* | **2.344.263** | **193.849.072** | 82,69 | **1.606.174** | **221.869.314** | 138,14 | **684.834** | **270.773.182** | 395,39 |
| Total Consumer Electronics | **164.265.132** | **1.411.252.891** | | **119.422.618** | **1.748.426.402** | | **85.504.889** | **1.684.235.771** | |

| Import Item | Amount (Units) | Value (USD) | Mean Unit Price (USD) |
|---|---|---|---|
| | **2007**** | **2007**** | **2007**** |
| CRT TV (screen diagonal<42 cm) | 8.239 | 866.122 | 105,12 |
| CRT TV (42 cm<screen diagonal <52 cm) | 98 | 26.927 | 274,77 |
| CRT TV (52 cm<screen diagonal <72 cm) | 17.321 | 4.466.837 | 257,89 |
| CRT TV (screen diagonal >72 cm) | 6.984 | 2.063.233 | 295,42 |
| CRT TV Subtotal | **32.642** | **7.423.119** | 227,41 |
| CRT TV Other*** | 96 | 58.945 | 614,01 |
| CRT TV Total | **32.738** | **7.482.064** | 228,54 |
| Plasma TV*** | 49.577 | 56.545.213 | 1.140,55 |
| LCD TV | 266.647 | 204.778.807 | 767,98 |
| Other TV | 3.278.167 | 491.385.754 | 149,90 |
| TV TOTAL* | **3.627.129** | **760.191.838** | 209,59 |
| Total Consumer Electronics | **601.478.514** | **2.216.683.435** | |

* The customs tariff position number "85-28" includes besides television sets, teleprojectors, color video projectors, and satellite television receivers. Since the latter constitutes only a small segment within the category, they were included in "Other TV" and hence 'TV TOTAL".

** The 2007 figures are provisional.

*** According to the legislation pertaining to data confidentiality, certain figures were not released.

Source: TÜİK, 2008b.

## The Turkish Domestic Market for Television Sets

The volume of home market sales for television sets is estimated to be around 2.5 million sets for 2007 including both cathode-ray tube televisions and LCD televisions, which together account for around 413 million US dollars (Turkish Ministry of Industry and Trade, 2008).

The cathode-ray tube television market in Turkey decreases by 50% yearly, and the LCD market grows by 100% (ibid.). A recent consumer research indicates that the growth trend for LCD and plasma televisions is likely to continue unabated. In the country-wide study conducted by GfK Turkey ("Türklerin," 2008), 23% of the consumers had plasma TV within the top five items they intended to buy; the comparable figure for LCD TV was 14%.

As television set penetration in Turkey is estimated at 97% for 2006 (World Bank, 2008), it can be inferred that demand for television sets is largely driven by renewal and replacement purchases. Television set lifespan is considered to be 12 years on average (Çakır, 2004: 11), but, renewal demand for new models with added features before the old TV set completes its lifespan is estimated to constitute about one-third of all renewal purchases per year, i.e., those spurred by new home purchases, opening up of a new business, and purchases of secondary sets in addition to the primary one (Çakır, 2004: 11).

The main brands in the home market are Beko with a 36% share, Vestel, with a 35% share, and Profilo with a 9% share for 2007 (Turkish Ministry of Industry and Trade, 2008). Vestel, Beko and Profilo also account for 95% of the current production capacity for television manufacturing (ibid.). Around 20% of home market sales are composed of imported brands (ibid.), which include Philips, Pioneer, Panasonic, Samsung, Sony, LG, and Toshiba (according to information obtained from various retailers). When it comes to LCD televisions, around 50% are imported. Of the 678.000 LCD TVs sold in Turkey in 2007, imported brands accounted for 44% (or, 300,000 sets) (Turkish Ministry of Industry and Trade).

**Table 13: Major manufacturers of television sets in Turkey**

| MAIN COMPANIES IN TURKEY'S CONSUMER ELECTRONICS INDUSTRY | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Proportion of exports in sales* (%) | Sales from production net* (YTL) | Export amount* ($) | Total TV sales (units)** | Total TV exports (units)** | Home market TV sales (units)*** | Company's share in the Turkish market for TV sales volume[a] |
| **VESTEL** | 89% | 2.395.395.531 | 1.688.850.000 | 8.776.324 | 7.372.112 | 1.404.212 | 35% |
| **BEKO ELEKTRONIK (now GRUNDIG ELEKTRONIK)** | 73% | 1.063.270.906 | 557.947.000 | 3.435.707 | 2.508.066 | 927.641 | 36% |
| **PROFILO TELRA** | 41% | 169.475.191 | 69.376.000 | | | | 9% |

* İstanbul Chamber of Industry (2008).
** Data is from the companies' annual reports for 2007.
*** Computed from the figures given in the annual reports.
[a] Turkish Ministry of Industry and Trade (2008).

It can be seen from the above figures that Vestel and Beko together account for around 90% of total TV unit exports for 2007.

Vestel is the top manufacturer of consumer electronics products; for instance, 67% of all televisions produced in Turkey today are manufactured by Vestel (Önkol, 2008). Vestel Electronics joined the Zorlu Group of Companies in 1994. The company manufactures and sells CRT TVs, TFT-LCDs, and monitors. In 2007, the company's market share in Europe was 21%; in CRT TVs, Vestel is by far the leader in Europe, with 50% of the market, and in LCD TVs, it has a market share of 11% (Vestel, 2008: 21). The company's central office is located in Istanbul, and the production plant is in Manisa, Turkey. The company is an OEM/ODM in the European Union, and in Turkey and neighboring countries, it markets its televisions under the Vestel brand name (Vestel, 2008: 20).

The second biggest manufacturer is Arçelik, considered the flagship of Turkey's biggest conglomerate Koç Group of Companies. Arçelik manufactures and sells its televisions under the brand names of Arçelik and Beko. Beko is the electronics arm of Arçelik, and following the recent acquisition of the prestigious German consumer electronics company Grundig in 2007, Beko Elektronik was renamed Grundig Elektronik, which was subsumed entirely under Arçelik in February 2009 (newspaper reports of February 28, 2009).

Profilo, the third biggest manufacturer, began production in 1972 with the manufacturing of black-and-white television sets. The company manufactures Philips-branded television sets in addition to its own brand and Telefunken.

## Opportunities and Challenges for the Industry

The biggest challenge facing Turkey's television set industry today appears to be the need for transition to LCD and plasma TV manufacturing. Eight out of ten television sets sold in Europe today are LCDs (Turkish Ministry of Industry and Trade, 2008), and the shift in consumer trends towards LCD and plasma televisions forces Turkish television producers to invest in new technologies (Tolga and Akın, 2008). For now, Turkish manufacturers produce LCD TVs using imported parts and run into difficulties obtaining LCD panels (Turkish Ministry of Industry and Trade, 2008).

The research and development costs required by LCD and plasma television set manufacturing are high, and Turkish manufacturers' total R&D spending is only a fraction of that of their Far Eastern rivals (Please see Table 14).

**Table 14: Television set manufacturers' research and development spending, 2007**

| **Industry Research and Development Spending, 2007** | |
|---|---|
| **Company** | **R&D Spending (Million US dollars)** |
| Samsung | 4,600 |
| LG | 4,000 |
| Daewoo | 3,000 |
| Hyundai | 2,000 |
| Turkey | 40 |
| Source: Turkish Ministry of Industry and Trade, 2008. | |

As it is, the television sets manufactured in Turkey are taxed at 55% (VAT: 18%, stamp tax 16%, special consumption tax 7%, customs duty 14%) (Önkol, 2008). With keen price competition, manufacturers complain of low profit margins and indicate the need for government support in R&D (ibid.).

Some government support came in 2008 in the form of a law to support research and development activities of industry (Legislation No. 5746, passed on Feb. 28, 2008). According to the law, investors will benefit until the year 2024 from a variety of incentives and government support irrespective of their area of activity.

Turkey's television set industry claims to have a highly qualified workforce of 12,300. The Turkish Ministry of Industry and Trade believes that over twenty years of export experience to Europe has resulted in a solid brand management capability and the establishment of a strong distribution and after-sales service network (Turkish Ministry of Industry and Trade, 2008). We have no independent evidence to support this claim.

A research report concluded that Turkish manufacturers also have the capability to manufacture to short schedules. In fact, some of the manufacturers in the industry are held up as examples of flexible manufacturing (Ateş, 2006: 137).

Some of the major television manufacturers in the international arena are forming strategic alliances in Turkey, and there is some indication that a few are moving some of their branded manufacturing operations to Turkey. Since 2004, for instance, Sony televisions are sold at Arçelik retail outlets, and in December of 2008, Grundig Elektronik, an Arçelik subsidiary which received a Sony OEM-Green Partner certificate, will be manufacturing Sony LCD televisions ("Grundig Elektronik," 2008).

Although the present export value of the Turkish television industry is not high in global terms, it is possible that with significant R&D investments (which the new legislation is likely to stimulate), engineering quality, and broad product range, the industry may in a number of years' time substantially increase its share of the global market. We make some further comment on global issues below.

# DISCUSSION AND CONCLUSION

In terms of the validity of the research evidence presented in this preliminary study, we are confident that it is statistically valid. Moreover, the data is longitudinal unlike immediate survey data and therefore presents a useful historical perspective on Turkish international development to the year 2008. We are also confident that we have been able to separate the factual evidence from the judgements of opinion formers in the industry.

However, there are three problems with the data. First, it does not take into account the major world downturn in the global economy that occurred in 2009 and possibly beyond this time. The early industry evidence suggests that this is having an impact on consumer electronics worldwide, including television set manufacture. It may therefore be that the picture presented in this report will change significantly over the year 2009. We will therefore re-visit the data at a later stage and adjust as necessary.

The second problem with the data is that it is eclectic and non-selective. It makes no attempt to develop hypotheses based on international development theories and then test them using the data. This report essentially summarizes the current information on the Turkish television set industry with regard to international development. Hence, it is possible that it includes information that will subsequently prove redundant. However, as a first step, we have judged it prudent to present a full picture of the data set. When we develop the research further, we would anticipate starting from a stronger basis in international trade research hypotheses.

The third problem with the data is that it provides only limited information on the reasons why the Turkish industry has developed along its current trajectory. For example, we know that exports have primarily been targeted at Europe but our only evidence on the reasons for this are, at best, anecdotal. The next stage of our research will address this area. But, as stated in the opening paragraphs, this report represents a preliminary study and it remains valid as a picture of the situation to year 2008.

In conclusion, this is only a preliminary examination of the Turkish television set market. The questions we will be exploring in further research will include the reasons why Turkish exports are mostly headed to the European Union within the context of international expansion strategies. Are there elements of cultural distance, administrative distance, economic distance, and in some instances, geographic distance, that are keeping Turkish manufacturers from expanding more into other markets beyond the EU? Why have Turkish exporters chosen particular strategies to export their goods? The answers may have critical implications for Turkish exporters in a variety of markets.

# REFERENCES


"Grundig Elektronik, Sony LCD televizyon üretecek." (Grundig Elektronik will manufacture Sony LCD televisions). (2008, December 27). *Hürriyet*, p. 12.

"Türklerin tekno rüyası, plazma TV, cep, laptop." (Plasma TV, cellular phones, and laptops are what consumers dream of). (2008, December 22). *Milliyet*, p. 6.

Ateş, R. (2006). *Şirket Doktoru*. İstanbul: Hayat Yayıncılık.

Axinn, C. N., Matthyssens, P. (2002) Limits of internationalization theories in an unlimited world. *International Marketing Review*, **19**(5), 436-449.

Barney, J.B. (1991), "Firm resources and sustained competitive advantage", *Journal of Management*, Vol. 17, pp.99-120.

Bartlett C.A. and Ghoshal S. (1989) *Managing Across Borders: The Transnational Solution*, Century Business, London.

Beko. (2008) Annual report 2007. Retrieved from www.beko.com.tr in December 2008.

Buckley, P. J. (2002) Is the international business research agenda running out of steam? *Journal of International Business Studies,* **33**(2), 365-373.

Çakır, E. (2004). Report on the Turkish Television Industry (*İTO Televizyon Sektör Raporu*). Istanbul: The Istanbul Chamber of Commerce.

Delios, A. and Henisz, W.J. (2003) Policy uncertainty and the sequence of entry by Japanese firms 1980-1998, *Journal of International Business Studies*, Vol 34, No 3, pp 227-241

Douglas S. and Wind Y. (1987) The Myth of Globalization, *Columbia Journal of World Business*, Volume 22, No.4, Winter, pp 19-29.

Doz, Y.L., Santos, J and Williamson, P (2001) *From Global to Metanational: how companies win in the global economy*, Harvard Business School Press, Boston, MA

DPT. (2007). *Elektronik ve Elektrikli Makinalar Sanayii: Özel İhtisas Komisyonu Raporu*. (Electronics and Electrical Machinery Industry: Report of the Special Expert Commission.) Ankara: State Planning Organization of Turkey.

DTM. (2006). *Elektrik-Elektronik Sektörü* (Electrical and Electronics Industry). Ankara: Undersecretary of Foreign Trade. Retrieved February 2009 from http://www.dtm.gov.tr/dtadmin/upload/ihr/otomotivelektrikdb/elektrik_elektronik_sektoru.doc.

DuBravac, S. G. (2007). The US Television Set Market. *Business Econom*ics 42, no. 3 (July).

Dunning J.H. (1995) *The Globalization of Business*, Routledge, London and NY, Ch 5.

Dunning, J.H. and Lundan, S. M. (2008) *Multinational Enterprises and the Global Economy*, 2nd Edition, Edward Elgar, Cheltenham UK, Tables 2.5 and 2.6

Eurostat. (2007). *Panorama of European Union Trade: Data 1999-2006*. Retrieved October 2008 from http://ec.europa.eu/eurostat.

Forsgren, M (2002) The concept of learning in the internationalization process model: a critical review, *International Business Review*, Vol 11, No 3, pp 257-277

Ghemawat, P. (2001) Distance still matters, *Harvard Business Review*, September, Vol 79, Issue 8.

Ghemawat, P. (2003) Semiglobalization and international business strategy, *Journal of International Business Studies*, Vol 34, pp 138-152.

Ghemawat, P. and Ghadar, F. (2000) The dubious logic of global megamergers, *Harvard Business Review*, July August, Vol 78, Issue 4.

Ghoshal, S. (1987) Global Strategy: an Organising Framework, *Strategic Management Journal*, Vol 8, pp 424-440.

Istanbul Chamber of Industry. (2001). *The Electronics and Telecommunications Sector* (Elektronik ve Telekomünikasyon Sektörü). Istanbul: Istanbul Chamber of Industry, publication no. 2001/17.

Istanbul Chamber of Industry. (2008). *Istanbul Chamber of Industry Magazine Special Issue: Turkey's 500 Largest Industrial Companies*. Istanbul: Istanbul Chamber of Industry, v. 43, no. 509 (August).

Johanson, J. and Vahlne, E. (1977) The internationalization process of the firm – a model of knowledge development and increasing market commitments, *Journal of International Business Studies*, Vol 8, No 1, pp 23-32.

Karabatı, S. and Tan, B. (2005). Vestel Electronics: Transition into the leading European TV manufacturer, Koç University Graduate School of Business, Istanbul, Turkey, Case Number 605-015-1.

Lynch, R. (2008) *Strategic Management* fifth edition, Pearson Education, Harlow. Chapter 4.

Önkol, B. (2008, 15 September). "Temel sorun üretmemek değil, değerli YTL ve düşen fiyatlar" (The main problem of the Turkish television industry is not production-related, but the valuable lira and declining prices). *Milliyet Business*: 7.

Peng, M. W. (2005) Perspectives---from China strategy to global strategy. *Asia pacific Journal of management,* **22**, 123-141.
Peng, M.W. and Heath, P. S. (1996): 'The growth of the firm in planned economies in transition: institutions, organisations and strategic choice', *Academy of Management Review*, 21:2 pp.492-528

Rugman, A.M. and Verbeke, A. (2003a) Regional Multinationals: the Location-Bound Drivers of Global Strategy, In: Burkinshaw, J., Ghoshal, S. , Markides, C., Stopford, J., Yip, G., (eds) *The Future of the Multinational Company*, Wiley, Chichester.
Rugman, A.M. and Verbeke, A. (2003b) Extending the theory of the multinational enterprise: internationalization and strategic management perspectives, *Journal of International Business Studies*, Vol 34, pp 125-137.
Tallman, S. (2001) Global Strategic Management. In: Hit, M.A., Freeman, R.E. and Harrison, J.S. (eds) *The Blackwell Handbook of Strategic Management*, Blackwell, Oxford.
Taylan, T. and Sarı, A. (2008). "Electronics industry", Export Promotion Center of Turkey.
TÜİK. (2008a). *Television production output, 1983-2007.* [Data file]. Ankara: The Turkish Statistics Institute.
TÜİK. (2008b). *Foreign trade statistics related to selected items between the years of 1998-2007*. [Data files] Ankara: The Turkish Statistics Institute.
Turkish Ministry of Industry and Trade. (2008). "Situation analysis of the television industry," Presentation (June), Ankara: The Turkish Ministry of Industry and Trade.
UNCTAD (2008) Handbook of Statistics Table 1.1 Value shares of merchandise exports and imports
Usta, H. (2002). Report on the Turkish Brown Goods Industry (*İTO Kahverengi Eşya Sektör Profil Araştırması*). Istanbul: The Istanbul Chamber of Commerce.
Vestel. (2008) Annual report 2007. Retrieved from www.vestel.com.tr in December 2008.
Werner, S. (2002) Recent developments in international management research: A review of 20 top management journals. *Journal of Management,* **28**(3), 277-305.
World Bank (2008). Retrieved from www.worldbank.org in October 2008.

# TURKEY'S ROLE IN PROCESS OF EURASIAN ECONOMIC AND STRATEGIC INTEGRATION

**Sefer Şener**
**Mesut Savrul**
**Çanakkale Onsekiz Mart University, Turkey**

**Cüneyt Kılıç**
**Istanbul University, Turkey**

**Yeşim Karadağ**
**Çanakkale Onsekiz Mart University, Turkey**

## ABSTRACT

*Because energy resources are one of the most important inputs of economic development, developed countries want to have them, produce them and take their transmission lines under their control. After the collapse of Soviet Union the Caspian Region took the interest of the world mainly because of abundant energy resources in the region. The region's economy is dependent on natural resources and the region has no outlet to seas so the countries in the region bound to each other for development. Also the region seriously needs foreign investment. Regarding the recent financial crisis which is collapsing powerful economies of the world, the region needs foreign investment and a widespread integration for development. However it's hard to establish a successful integration and some strict fulfilments need to be met for a functional integration.*

*In the study an economic integration that will be set in Eurasia according as political, martial, social and economic developments as international economic integration will be emphasized. In the first part of the study types of integration, requirements for a functional integration, advantages and disadvantages of such integration will be discussed. In the next section, economic, cultural and social statuses of the countries in the region will be presented. In the third section of the study current managerial and economics of the countries, existing integrations and strategic sharing will be discussed. Finally in the last section, depending on the theoretical conditions mentioned in the first section, whether it will meet the conditions that a functional integration needs, What Turkey's roles will be in the establishment phase of such an integration and benefits of such an integration to Turkey and to countries in the region if an integration in Eurasia area is set will be discussed. Besides administrative side of this integration process, economic and cultural faces will be dealt and what kind of effects may occur in formation, development and resultant phases will be evaluated.*

***Keywords:*** *Economic Integration, Strategic Sharing, Integration in Eurasia, Eurasian Economic Policies.*

## INTRODUCTION

Today globalization movements reached to such an extend that it's hard for a country to stay out of international issues and this plot force countries which want to have a voice in world politics and economy to integrate in politic and economic areas. Countries get into commercial and economic integrations to increase their production capacity, enhance their productivity and social welfare International economic integrations play a significative role on economic potential of countries a large economic market, inner and outer economies, technological development, rivalry and increase in their productivity. The countries willing to join the process of integration aim to take the advantage of the integration and maximize the common benefits of the member countries. However for success of integration some conditions such as likeness of economic structure, complementing each other, rivalry, political and cultural closeness need to be met.

As a result of globalization movements which covered the whole world; lots of economic cooperation organizations were established. The Central Asia and The Middle East stayed out of these integrations. Besides a serious integration that could unify Asia and Europe couldn't be realized. Integration on energy, trade, labour movement and transport will fairly increase production and trade capacity of the countries in the region. Turkey's being at the centre of region is important for the integration. Anatolian geography that always has been on important trade routes in the history has affected the economic relations in Europe, Asia, the Middle East and the Balkans. Furthermore Turkey's having political, economic, socio-cultural and administrative links makes Turkey's strategic role in dual relations more important. In this regard, the number of organizations such as "Organization of Black Sea Economic Cooperation" should be increased and the region to be widened in terms of forthcoming new arrangements seems compulsory. Turkey will have a strategic importance in forthcoming economic integration process between Asia, Europe, and Middle East.

## 1. ECONOMIC INTEGRATION

Economic integration term refers to movements of goods, labour and capital between countries and expansion of their collaboration areas (Aktan, 2007). In frame of this definition economic integration is beyond being limited to specific geographical areas and it aims to bring all the actors related to each other together in the same system (Ergin, 2008:191). It is possible to mention these three rules on economic integrations (Ergin, 2008);

- The base of economic integrations is collaboration,
- In further phases of integration free circulation of goods, services and production factors is envisaged,
- Economic integrations cover abolishing special treatment to goods, services and production factors according to their destinations.

### *1.1. The Reasons for Economic Integration to Arise*

The countries get into integrations because of political, cultural and economic reasons. Their main aim is to minimize the difficulties they had in the international area. It is possible to summarize the reasons for the countries to get into economic integrations (Ergin, 2008:63-64, Seyidoğlu, 1998:266);

- Economic integrations enhance increases economic production capacity of the countries so productivity in economy rises and depending on these, social welfare reaches to maximum level. It is possible to reach these aims by getting into international commercial and economic integrations to increase market volume.
- It is possible to reach these aims by joining international commercial and economic integrations depending on increasing market volume.
- The strategies such as getting more rivalry power against the countries out of the integration and taking part in international political race more efficiently is another reason for economic integrations to arise.
- The last reason for economic integrations to arise is the efforts to fix the possible disagreements between the countries which have to live together in the region.

### *1.2. Phases of Economic Integration*

Economic Integration process has different dimensions and forms. The countries get into integration phase to keep on their development process passing through different stages and under different circumstances. It is possible to classify these different integration types under some common types (Uyar, 2007:105);

- Free Trade Association,
- Customs Union,
- Common Market and
- Economic Union.

**Table 1: Phases of Economic and Characteristics**

| Phases of Economic Integration | Free Trade between Members | Common Customs Tariff | Free Circulation of Production Factors | Accordance in Economic Policies |
|---|---|---|---|---|
| **Free Trade Association** | ✓ | × | × | × |
| **Customs Union** | ✓ | ✓ | × | × |
| **Common Market** | ✓ | ✓ | ✓ | × |
| **Economic Union** | ✓ | ✓ | ✓ | ✓ |

**Source:** Miroslav N. Jovanovic (2006); **The Economics of International Integration,** Switzerland, p.23 and UNCTAD (2007); **Trade and Development Report 2007**, New York and Geneva, p.89.

As seen in Table 1, the weakest type of integration is Free Trade Associations in terms of advantages that member states benefit. Because it only provides free trade between the member states. Customs Union, Common Market and Economic Union follow Free Trade Associations in terms of advantages they have. So that, the most advantageous integration type is Economic Union.

## *1.3. Conditions for a Successful Economic Integration*

The countries which want to join integration process aim to benefit from the advantages of the integration and to maximize the common expedience of the union. Success chance of the integration changes depending on the differences of the expectation of the member states by short or long term. For an integration to be successful it has to fulfill some requirements. These are (İncekara, 1995: 87-97);

- *Similarity in Economic Structure;* success chance of economic integration chances depending on development level of member states. Integration between the countries which have similar economic structure is usually more successful than the ones whose economic structure has differences.
- *Complementariness and Rivalry;* if the economies which form the integration are rival that is to say they produce similar goods or they have similar cost structure, the integration will be more successful since the situation will have more effect on creation of trade. On the other hand if the member states produce supplemental goods, success chance of the integration will be limited.
- *Policies of Balance of Payments and Exchange Rate;* likeness of policies of balance of payments and exchange rate of the member states will increase success chance of the integration on the other hand differences in the policies will limit the success of the integration.
- *Sufficient Infrastructure;* developed infrastructure possibilities in the region will increase the success of the integration; a contrary situation will decrease the chance.
- *Investment Policies;* likeness in investment policies of the member states will increase the success of the integration, different policies on the other hand will effect the chance badly.
- *Political and Cultural Likeness;* as much as the similarities in the economic structure of the member states political and cultural approximate effect the success of the integration. Integration of similar culture and policy has more chance to establish a successful integration.

## 2. ECONOMIC STRUCTURE OF EURASIA

After industrial revolution an incredible increase in production, technological developments, and increase of speed of transportation, ease in communication helped capital, labour, information and technology movement to get intense between countries besides goods and services. So that national economies connected to each other with movements which are gradually getting more complex and dense. International commercial activities are much more complex than the ones inland because of the differences in laws, political and economical systems, money, language and markets of the countries (Uluslar arası Ekonomik İlişkiler, http://www.ekodialog.com/ uluslararasi_ekonomi/uluslararasi_ekonomik_iliskiler.html (2009).

After the Cold War, globalization which made its mark on new order started big races between countries. Today regional alliances which are established by the countries which have common benefits to resist negative effects of this fact is still important (Avrasya Ekonomisi, http://www.ekodialog.com/Makaleler/ avrasya_ekonomisi.html, 2009) Eurasia which is regarded as the heart of the world became a region where all the global and regional powers tried to become effective because of its strategic position and rich energy resources. Latterly accelerating race of establishing military bases and providing rent from the area totally changed the dimension of the rivalry in the region (Fırat, 2007:79-81)

Central Asia which was once an obscure and little-known region, has become an important test of America's ability to consistently promote global liberal change, of Russia's true foreign policy agenda, and of China's readiness to translate economic power into political influence. Terrorism, economics, and politics all converge in this strategic region, with important implications for Asia and the world (Davis, 2006). Deichmann (2003: 1767-78) mentioned that since human power and social capital is the most important determinant of the distribution of investments foreign direct investment is still going on to flow into the transition economies of Eurasia. Another condition necessary for the inflow of foreign capital is raw resources most of which is mass in the region. Also developing human and social capital, labour skills and infrastructure, reform policies, investment, and trade effect the decision of investors.

Eurasia region has a geographical area of approximately 23 million m², an average growth rate of 5.75% and a GNP of 1.2 trillion USD (Bahar, 2008:20). When China and India added to this GNP it counts more than half of total world GNP. Development rates of developping countries of Eurasia have a larger potential to overcome global crisis compared to industrialized countries. China and India is expected to go on developing for 20-30 more years and join economic powers of the world and some of today's facts will radically change (Sudi, 2009:8). When the GNP of the region and foresights regarded the place of the region for the world economy is much more important.

Export and import volume of Eurasia area is too low when it is compared with the average world rates. Trade volume of the area is approximately 40 billon USD. The reason for this is more than half of export goods of most of the countries in the region such as Russia, Iran, Azerbaijan, Tajikistan, Turkmenistan, Kazakhstan and Mongolia are natural resources and they import industrial good with the revenue they gathered from export of natural resources (Uzunoğlu, 2009:11). So their trade structure isn't self sufficient.

**Table: 2.1 Gross Domestic Product of selected Eurasian and Asian Countries (Current Prices, Billion USD)**

| **Country** | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** |
|---|---|---|---|---|---|---|
| **Armenia** | 2.807 | 3.577 | 4.9 | 6.384 | 9.204 | 11.928 |
| **Azerbaijan** | 7.276 | 8.682 | 13.245 | 21.027 | 31.287 | 46.378 |
| **Georgia** | 3.992 | 5.126 | 6.411 | 7.768 | 10.227 | 12.87 |
| **Kazakhstan** | 30.86 | 43.152 | 57.124 | 81.003 | 104.85 | 132.229 |
| **Kyrgyz Republic** | 1.919 | 2.215 | 2.46 | 2.837 | 3.806 | 5.049 |
| **Russia** | 431.429 | 591.902 | 764.256 | 989.428 | 1,294.38 | 1,676.59 |
| **Tajikistan** | 1.555 | 2.073 | 2.311 | 2.811 | 3.712 | 5.135 |
| **Turkmenistan** | 11.424 | 14.196 | 17.175 | 21.395 | 26.201 | n/a |
| **Uzbekistan** | 10.129 | 12.001 | 14.31 | 17.027 | 22.307 | 27.918 |

**Source:** International Monetary Fund, World Economic Outlook Database, April 2009

As seen in Table 2.1 GDP of all the countries in the region are in a growing trend and on the average the countries quadrupled their GDP in the last five years. However except from Russia and somehow Azerbaijan and Kazakhstan despite their mass energy resources the countries in the region are apart from having a voice in the world economy. Regarding their developing trend, energy resources and cheap labour force integration in the region will help them arouse their economic potential.

On the other hand it is not possible to generalize trade structure of all Eurasian Countries. The countries have different development rates and production potential but the common denominator that gathers them together is that the countries are strategically and logistically bound to each other. Because of this bind the countries have to share their savings with their neighbours and develop their trade volume to increase their rivalry power (Uzunoğlu, 2009:12).

Another point is that in great injustices exist in distribution of income between the counties in Eurasia. There is an economic structure in which different richnesses distributed to different areas. Especially insufficiencies in markets deteriorate the use of economic potential efficiently. Interest of foreign investors to the region is centered on natural resources of the region. Finance sector and service industry are away from competing against world standards except Turkey and somehow Russia. To eliminate these deficiencies, the countries in the region should work together to effectuate integration between markets. Although some countries in the region have such enterprises of integration, these enterprises should be more widespread. Especially the countries whose economy depends on natural resources will benefit greatly from this kind of integration to develop their markets (Sudi, 2009:15-18).

**Table: 2.2 Inflation Rates of Selected Eurasian and Asian Countries, (End of Period Consumer Prices, Annual Percent Change)**

| Country | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| **Armenia** | 8.6 | 2.003 | -0.182 | 5.23 | 6.648 | 5.2 |
| **Azerbaijan** | 3.551 | 10.441 | 5.549 | 11.385 | 19.533 | 15.4 |
| **Georgia** | 6.953 | 7.503 | 6.179 | 8.778 | 10.983 | 5.548 |
| **Kazakhstan** | 6.756 | 6.713 | 7.536 | 8.358 | 18.758 | 9.474 |
| **Kyrgyz Republic** | 5.563 | 2.764 | 4.92 | 5.097 | 20.052 | 20.06 |
| **Russia** | 12 | 11.7 | 10.9 | 9 | 11.9 | 13.3 |
| **Tajikistan** | 13.731 | 5.732 | 7.125 | 12.514 | 19.846 | 11.8 |
| **Turkmenistan** | 3.059 | 9 | 10.354 | 7.098 | 8.648 | 11.99 |
| **Uzbekistan** | 7.787 | 9.09 | 12.335 | 11.429 | 11.917 | 14.449 |

**Source:** International Monetary Fund, World Economic Outlook Database, April 2009

As mentioned before likeness of economic structure is a must for the success of an economic union. Inflation rates are one of the noteworthy indicators of economies. Table 2.2 shows that inflation rates of the countries in the region are alike and this will support a possible integration in the region by means of common aims the integration will work for. However the rates are far above the world standards and the countries need urgent economic reforms to lower their inflation rates.

## 3. ECONOMIC INTEGRATION IN EURASIA

After the collapse of the Soviet Union, a security vacuum in the Eurasian space has been created from the Baltic Sea to China. Within this context, Eurasia has attracted the attention of global actors as well as regional ones, mainly due to its abundant energy resources. While the new states of the region search for a place in global politics, rivalry for the transmission of Eurasian resources between global actors has been so intense that pipeline politics has become the key theme of this New Great Game for controlling the Eurasian Heartland. Regarding natural gas, the Eurasia needs considerable investment in upstream fields but this is not sufficient by itself when we consider the fact that the reserves are located at a great distance from all their potential consumers in Europe and Asia (Özdemir, 2007:135-148).

One of the main topics that shape agenda of EU is relations with Caucasian within the context of Union Neighbourhood Policy. EU’s interest on the region raised up due to increase energy supply, develop infrastructure of trade and transportation links, reduce the conflicts that may break out near by the union and to ensure stability and security of its borders (Kocamaz, 2007: 66). When the importance of the region evaluated in frame of EU, geopolitical situation is the leading point. The region is the intersection of different balances. With the last enlargement process EU’s borders reached to Black Sea and it became neighbour with the region. So that the conflicts, possible instabilities and the strategies in the region takes interest of EU.

**Table 3.1 Primary Energy Production and Resources 1971-2030 (MTOE)**

| Resources | 1971 | 2000 | 2010 | 2020 | 2030 |
|---|---|---|---|---|---|
| **Total** | 4999 | 9179 | 11132 | 13167 | 15267 |
| **Renewable Resources** | 73 | 233 | 336 | 457 | 618 |
| **Hydroelectricity** | 104 | 228 | 274 | 327 | 366 |
| **Nuclear** | 29 | 674 | 753 | 719 | 703 |
| **Coal** | 1449 | 2355 | 2702 | 3128 | 3606 |
| **Natural Gas** | 895 | 2085 | 2794 | 3531 | 4203 |
| **Oil** | 2450 | 3604 | 4272 | 5003 | 5769 |

**Source:** Sadi Uzunoğlu et al. (2006); Avrasya Bölgesinde Ekonomik Entegrasyonun Uygulanabilirliği Üzerine Bir İnceleme S:11-14, http://sadiuzunoglu.trakya.edu.tr/doc/ahmet.pdf

Another point that takes EU's interest is the abundant energy resources in the Caspian region. EU consumes 16% of total world energy production and it's the second biggest energy consumer in the world. Petroleum products are leading with 41% within its energy consumption. With the current policies petroleum import rate will reach to 90% in near future due to limited energy resources and production in the Union (Kocamaz, 2007: 67-68). In this context, the EU interests with the region to open alternative corridors for energy resources transfer such as Turkey and the Black Sea (Baran, 2007:142-143).

World energy resources demand estimates are shaped by assumptions of total development rates of the countries' economies. Within this context world energy demand assumptions are made depending on an enlargement rate of 3% for the world economy and 5% for the developing countries. Statistical assumption models show that an increase of 55% is inevitable for the consumption of primary energy resources from 2000 to 2030 (Uzunoğlu, 2009:11-14). Table 3.1 shows that production of energy resources in the region is in a growing trend and especially natural gas and oil that EU interested in will maintain this trend at least 20 more years. So it will be beneficial for EU to invest on energy resources in the region.

**Table 3.1 Direct Investment (USD, Billions)**

| Country Group Name | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| **Commonwealth of Independent States** | 5.399 | 13.056 | 11.595 | 20.736 | 26.617 | 44.415 |
| **Developing Asia** | 70.559 | 64.714 | 100.536 | 94.349 | 138.455 | 222.573 |
| **Middle East** | 16.973 | 10.419 | 17.648 | 14.897 | 4.007 | 11.435 |

**Source:** International Monetary Fund, World Economic Outlook Database, April 2009

Besides energy resources raw materials, developing substructures, cheap labour and large markets attracts direct foreign investment to the region in many fields besides energy production and marketing. As seen in table 3.1 the region is one of the most attractive areas of the world in terms of direct investments. In the last five years while Developing Asian countries tripled their investments, direct investments in Eurasian countries increased approximately nine times. In this increase recent development in their economic relations and recent integrations is apparent. So a widespread integration in the region can make the region a more desirable area for the investors.

**Table 3.2 Import volume of goods and services (Annual percent change)**

| Country Group Name | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| **Commonwealth of Independent States** | 20.193 | 19.24 | 14.667 | 18.709 | 23.524 | 15.081 |
| **Developing Asia** | 15.345 | 19.018 | 12.935 | 12.429 | 11.471 | 10.255 |
| **Middle East** | 4.007 | 14.045 | 13.241 | 12.947 | 13.566 | 19.93 |

**Source:** International Monetary Fund, World Economic Outlook Database, April 2009

The region's foreign trade volume is 61 billion USD for exports, 66 billion USD for imports within the region and 340 billion USD for exports and 215 billion USD for imports with the world. CIS countries have a regular external deficit and with a Eurasian Integration their foreign trade volume will have a rising trend. CIS countries' having common history is important for establishing integration. Rich oil and natural gas resources and their being a large market lead the region in a rapidly growing situation (Şanlı, 2008:19-26). Table 3.2 displays high rise in import volume of the region. Although it seems to slow down, the rate is over 15 percent on the average and above many regions in the world. This trend is expected to go on for a long time due to high population and substructure developments.

**Table 3.3 Export volume of goods and services (Annual percent change)**

| Country Group Name | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| **Commonwealth of Independent States** | 12.785 | 13.452 | 4.466 | 7.793 | 8.507 | -0.621 |
| **Developing Asia** | 14.768 | 20.242 | 17.635 | 18.015 | 14.985 | 10.383 |
| **Middle East** | 10.982 | 9.984 | 4.248 | 4.788 | 3.837 | 7.828 |

**Source:** International Monetary Fund, World Economic Outlook Database, April 2009

After a boom in export rates in 2003 and 2004, the regions export rates of goods and services fallen down and finally in 2008 it fallen down to below zero as a result of economic crisis that effected whole world deeply. Although the region has abundant energy resources and raw materials it has marketing problems mainly due to economic and political instabilities. The region needs urgent reforms in social and economic area but the countries defer these reforms due to lack of capital. A possible economic integration will help the countries overcoming marketing problems and accelerate the reforms they need.

The economic differences between the states in the region reveal the need for a union and some attempts of establishing integrations can be seen in the region some of them are;

- The Black Sea Economic Cooperation
- Eurasian Economic Community
- Middle East Economic Cooperation Organization
- Common Economic Space
- Collective Security Treaty Organization and
- Shanghai Cooperation Organisation.

These formations help CIS countries to get into a new economic structure and to be integrated with the international economic system. These formations lay groundwork for creating a single market in which some powerful states such as China, India, India and Iran, developing rapidly putting financing possibilities to good account (Fouskas, 2007:444). In addition to economic relations by the help of regional committees these countries established collaborations on cultural, environmental and scientific issues (Yüce, 2009).

We can see how the countries in Eurasian region may benefit from integration in the region with The Shanghai Cooperation Organization (SCO) and The Black Sea Economic Cooperation example. With the establishment of the SCO, some improvements such as rehabilitation of infrastructure, increased interaction in the business and banking sectors, energy cooperation actualized in the region. Unfortunately the SCO's trade program currently lacks a regional strategy for trade facilitation. Although the economies of the SCO member states are booming with official growth rates pending between 5 and 10 per cent for all states, there is great need for further efforts to take full advantage of the potentials that have opened (Norling, 2007:434-435). Regarding the positive effect of a limited organization a widespread integration in the region will have much better effects on culturally, politically and primarily economically.

## 4. TURKEY'S ROLE IN INTEGRATION OF EURASIA

Turkey has tight links with Eurasian countries with which Turkey share its history and culture. However Turkey has only 4% of Eurasian trade volume and Eurasian Countries take 10% from trade portion of Turkey. These figures points out the urgent need in a development of trade relations with these countries. Turkey's ability to affect Caucasian and the Muslim population in the region and Russia's considering Turkey as a partner for the transport of energy resources through the Straits make Turkey a significant partner of the integration (Avrasya Ekonomisi, http://www.ekodialog.com/Makaleler/avrasya_ekonomisi.html).

There is a strategic foreign and security policy between Turkey, Europe, and the United States. If Turkey joins the EU, this multiregional actor will help connect various strategic basins and cultures, generate a credible pull factor for being change in its neighborhood, help Europe in its aspirations to become a global actor. (Akçapar, 2006). On the other hand besides relations with European countries, Turkey shouldn't disregard Asia and Middle East and should seek for economic integrations with the countries in those regions.

## 4.1. Turkey's Approximity to Countries of Caspian Region, Middle East and Balkans Culturally and Historically

The late twentieth-century leaders of Turkey have defined Turkey as a modern, secular, Western nation state. They allied Turkey with the West in NATO and in the Gulf War; they applied for membership in the European Community. At the same time, however, elements in Turkish society have supported an Islamic revival and have argued that Turkey is basically a Middle Eastern Muslim society (Samuel, 1993:42). After the collapse of Soviet Union many new countries turned up in Eurasia Region. This resulted a reconciliation of the Turco-Muslim minorities in the region. Unless a widespread integration is established in the region, the Turco-Muslim world does not actually have any sense by itself (Laruelle, 2004:123).

The most considerable problem in Caspian Basin is instability and government authority is centrical and too strict. In investment processes governments interfere with any steps without regarding the international rules. However the region seriously needs foreign investments. Another issue is status of Caspian Sea. Coastal states have troubles in sharing the sea and there isn't an agreement that satisfies all the states in the region (Laçiner, 2006:36). Turkey plays an important role in solving political crisis in its neighbourhood. Especially in Arabian-Israel and Middle East peace process Turkey had a great contribution. In frame of international organizations Turkey had an active participation (Gözen, 2006:10-11). In this respect Turkey will be one of the most crucial for the possible integration in the region.

## 4.2. Turkey's Geographical Approximity to Europe, Asia, Caspian Region and Middle East

To understand the complexity of conflicts and co-operation around the energy resources in Central Eurasia and the Caspian Region in particular, however, analyses continue to view the post-Soviet international politics of Central Eurasia in the light of a New Great Game. Researches in this field remains gathered around pipeline routes, actual and potential, and the challenge of oil and gas transport from the Caspian basin (Fouskas, 2007 p:444-445).

The European Union is the world's biggest gas import market while it is also one of the world's fastest-growing energy markets. The EU is already in receipt of large volumes of gas from three main sources - Russia, the North Sea and North Africa - Turkey's goal is to become Europe's fourth main artery. EU countries do not want to depend on only Russia in terms of importing such an important energy source. It is clear that EU countries are seeking for new alternative sources and routes for securing their energy demands (Volkan Özdemir, 2007:143-144). The EU and the United States are supporting two gas pipelines directly to Europe, one from Turkey to Greece and Italy, called TGI, and the second from Turkey across Bulgaria, Romania, and Hungary and into Austria, known as Nabucco (Baran, 2007:137).

Besides transfer of energy resources another important matter is land transportation. Baku- Tbilisi-Kars railway project which will be an important connection between Asia and Europe will have great contributions to Eurasia-Turkey relations. When the project is effectuated it will be possible to transport goods by railway without interruption. With the completion of ongoing Marmaray project which will connect two continents a corridor up to London will have been established (Avrupa'dan Çin'e yeni İpekyolu, http://www.taraf.com.tr/haber/13139.htm, 25.07.2008).

## 4.3. Turkey's Economic Relations with Europe, Asia and Middle East

Turkey which has similar structural characteristics with Far East countries, has better possibility to compete and collaborate with these countries compared with the EU countries (Akdemir and Şener, 2005:1971) so in a possible Eurasian Integration Turkey will play and mediator's role in commercial area between western and eastern countries.

Turkey's trade volume towards Eurasian countries reached 5 billion USD. Yet relations with those countries aren't limited with trade, Turkish private companies invested on various sectors such as banking, telecommunication, transportation, energy, food, construction, textile a sum of 7 billion USD. Furthermore the total amount of commitments of Turkish undertakers in the region reached to 19 billion USD.

**Table 4.1. Turkey's Imports by Country Groups**

| *Countries* | *2003* | *2004* | *2005* | *2006* | *2007* | *2008* |
|---|---|---|---|---|---|---|
| ***E.U. Countries (27)*** | 27393762 | 36580859 | 41364962 | 47934746 | 60398502 | 63378466 |
| ***Other Europe*** | 3361997 | 4507410 | 5855304 | 7961672 | 10842681 | 15676273 |
| ***Near And Middle Eastern*** | 5464810 | 7921284 | 10184230 | 11315751 | 15081322 | 25428884 |
| ***Asian Countries*** | 2347927 | 2544121 | 3028878 | 3941556 | 5227250 | 7073880 |
| ***New Independent States*** | 2962593 | 3961619 | 5056779 | 6992529 | 10088336 | 13935670 |
| ***Turkish Republics*** | 899114 | 1194307 | 1409257 | 1981603 | 2874467 | 3749225 |
| ***Total*** | 47252836 | 63167153 | 73476408 | 85534676 | 107271750 | 132001810 |

Source: T.C. Başbakanlık Gümrük Müsteşarlığı, http://www.gumruk.gov.tr/Istatistikler/Default.aspx

Turkey is one of the best examples for displaying what an economic integration is good for. In 2003 Turkey started negotiations with the E.U. which Turkey desired to get into and spend a great effort for more than the last 5 decade. Due to improvements with the relations with the E.U. Turkey's imports from E.U. doubled in last five years as seen in Table 4.1. Imports from E.U. reached to half of Turkey's total imports which have tripled in five years. When the table investigated the most striking change is imports from Eurasian Countries. With the help of developing economic relations and economic integrations in the region imports from those countries reached up to five times larger volume.

**Table 4.2. Turkey's Exports by Country Groups**

| *Countries* | *2003* | *2004* | *2005* | *2006* | *2007* | *2008* |
|---|---|---|---|---|---|---|
| E.U. Countries (27) | 35140139 | 48102744 | 52695793 | 59400922 | 68611562 | 74800962 |
| Other Europe | 10341499 | 15756926 | 20385906 | 25695361 | 34253510 | 44196401 |
| Near And Middle Eastern | 4455199 | 5584836 | 7966854 | 10568063 | 12641279 | 17627007 |
| Asian Countries | 9643755 | 15500398 | 20581162 | 25657979 | 33658278 | 38086659 |
| New Independent States | 7777111 | 12926894 | 17252743 | 23372924 | 31262659 | 42613283 |
| Turkish Republics | 623295 | 753526 | 1267479 | 1967429 | 2669249 | 4278503 |
| Total | 69339692 | 97539766 | 116774151 | 139576174 | 170062715 | 201960779 |

Source: T.C. Başbakanlık Gümrük Müsteşarlığı, http://www.gumruk.gov.tr/Istatistikler/Default.aspx

Turkey's exports display a similar scheme. Again the negotiations with E.U. affected Turkey's foreign trade volume positively and Turkey's export volume tripled in just five years. Turkey's exports to E.U. countries increased more than two years in the last five years and reached to one third of Turkey's total export volume. Change in export volume, which has raised up to an eight times larger volume on the average, to Eurasian countries is more striking than import volume. Current status displays positive effects of present integrations and the urgent need for a widespread economic integration in the region for further increase in import and export volumes.

Transportation is another face of trade. Baku- Tbilisi-Ceyhan pipe-line and Baku-Tbilisi-Erzurum natural gas project which will be actualized in near future are the examples of the collaboration on energy. Kars-Tbilisi-Baku railway will be a direct transportation option from Europe to China which means reviving historical Silk Road (Bakü-Tiflis-Kars demiryolu hattı, http://tr.wikipedia.org/wiki/Bak%C3%BC-Tiflis-Kars_demiryolu_ hatt%C4%B1).

Trade is another aspect for the relations in the region. Lately Turkey invited businessman for "Turkey-Eurasia Foreign Trade Bridge" program from Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Uzbekistan, Russia, Tajikistan, Turkmenistan and Ukraine. In the program negotiations on furniture, electronic goods, textiles, medicine industry, construction businesses and tourism have been held. In the program about 15 thousand business intercourses and business connections to amount of 250 million USD have been succeeded (Türkiye–Avrasya Dış Ticaret Köprüsü, http://www.tarafgazetesi.com.tr). As well as Turkey's investments in the region, these countries began to invest in Turkey too and the sum of investments exceeded 8 billion USD (Türkiye Avrasya Dış Ticaret Köprüsü, http://tuskon.org/faaliyet/detay.php?id=22 İstanbul, 04–05 Aralık 2007).

## 4.4 Turkey's Political Position in the Region and Political Relations with the Countries in Europe, Asia and Middle East

Turkey's example as a secular democracy with a Muslim-majority population can inspire reformers in the Caucasus, Central Asia, and broader Middle East who seek the same political freedom, prosperity, and stability that Turkish citizens increasingly enjoy. (Fried, 2008: 30-34). Although some of the EU countries have Black sea, the sea and the Caspian Region have a very strategic importance for EU. Black sea and Caspian region have a very high strategic importance for EU. As Black Sea country Turkey will play a prime role building bridge between Black Sea, Caspian Region and EU in commercial and political fields. In this respect Turkey plays an important role for EU policies.

Both Balkan countries in the west and Caspian countries in the east have a sizable Turkish and Muslim population. These people feel themselves very close to Turkey. This provides Turkey an advantage of having effecting ability on them in political area. Besides managerial relations, Turkey's huge military power economic relations with west and east, large population and the late developments on social, cultural, economic and jural fields makes Turkey a noteworthy for the integration in Eurasia.

## CONCLUSION AND SUGGESTIONS

Eurasia geography is one of the ascending economic powers of the world due to its great economic potential. Eurasia region is usually define as the states turned up with the collapse of Soviet Union but because of its geopolitical situation many other neighbour countries such as Turkey, Iran, Russia, India and China and even some unions such as EU are closely linked with the region. Eurasian region needs a couple of economic reforms for integration. The regions economy is based on natural resources and trade is limited. The capital is short in many of the countries in the region but labour is abundant. Many countries in the region head towards associations to develop their economic relations and to have a voice in global markets. However to establish an integration such as EU the region has to solve some problems such as terror, narcotics traffic, political disagreements, economic structure differences.

If we review the requirements for a successful integration, it can be deducted that without Turkey success chance of the integration will be thin.

Similarity in Economic Structure; Asian and European economic structure and policies are pretty distinct. On the other hand Turkey has close economic relations with both region and can play a role of mediation between them.

Complementariness and Rivalry; Eurasian countries have mass energy resources, raw materials and cheap labour force but lacks of capital for developing their substructure and industrializing on the other hand European countries have large capital accumulations but lack of energy resources and labour force. In this respect Turkey can help transfer of these inputs to each other for the good of both regions.

Policies of Balance of Payments and Exchange Rate; Another difference between eastern and western countries is policies of balance of payments and exchange rates. Turkey has both similarities with western and eastern countries and can mediate trade relations of Eurasian countries with the West.

Sufficient Infrastructure; one of the most crucial problem that hinders industrialization and development of trade is insufficient infrastructure in Eurasian countries. Many Turkish private sectors are working in the area on infrastructure field and with and integration these efforts will probably increase.

Investment Policies; as mentioned before one of the problems the region suffer from is lack of capital and this situation hinders investments in the region. The region urgently needs foreign investments and mainly from Western countries that are interested in the energy resources of the region. In transportation and marketing of these resources Turkey is one of the best routes.

Political and Cultural Likeness; The region has a large Turkish and Muslim population and Turkey has affection ability on these population in addition to this has strict political and cultural relations with many countries in both Eurasian region and East Europe. In this respect the integration may benefit from Turkey reasonably.

Consequently Turkey is one of the key countries for the integration in Eurasia. Turkey is in the center of Asia and Europe and has a common historical inheritance with Asia, Middle East and Europe. Because of this Turkey meditates in many political crises between the neighbours. Turkey has relations with both Asian and European countries not only on cultural and politic issues but also economic structure and trade. Additionally Turkey is one of the safest routes between Asia and Europe for land transport and oil and gas pipelines. All these issues characteristics make Turkey a strategic partner for a possible Eurasian Integration

# REFERENCES


Akçapar, Burak (2006); Turkey's new European era: foreign policy on the road to EU membership, Rowman & Littlefield, UK.

Akdemir, Ali and Sefer Şener (2005); The Strategic Contributions of Turkey's Full Membership to European Union along with Their Financial Dimensions, Future of Banking, Czech Republic, 1968-1991.

Aktan, Coşkun Can (1999); "Global Ekonomik Entegrasyon ve Türkiye", Dış Ticaret Müsteşarlığı Dergisi, Year: 4, No: 12, Ankara, p.1-29. http://www.dtm.gov.tr/dtmadmin/upload/ead/tanitimkoordinasyondb/global1.doc (25.11.2007).

Alıcı, Murat (1995); "Ekonomik Entegrasyonun İspanya'ya Yönelik Yabancı Doğrudan Sermaye Yatırımları Üzerindeki Etkisi", Ekonomik Yaklaşım Dergisi, Vol:6, Number:16, p.47-64.

Alpar, İstiklal (1993); "Ekonomi ve Çevre Politikalarının Entegrasyonu", Ekonomik Yaklaşım Dergisi, Vol:4, Number:9, p.103-108.

Apak Sudi vd. (22.02.2009); "Enerji Pazarında Avrasya Ülkelerinin Küresel Etkinliğin Artırılmasında Finansal Piyasaların Önemi", http://sadiuzunoglu.trakya.edu.tr/doc/finans.pdf, p.15-18

Aslaner, Bekir (1995); Uluslararası Bütünleşmeler ve Türkiye, T.C. Başbakanlık Dış Ticaret Müsteşarlığı Expertise Thesis, Ankara.

Avrasya Ekonomisi (22.02.2009); http://www.ekodialog.com/Makaleler/avrasya_ekonomisi.html

Avrupa'dan Çin'e yeni İpekyolu (25.07.2008); http://www.taraf.com.tr/haber/13139.htm

Bakü-Tiflis-Kars demiryolu hattı (25.07.2008); http://tr.wikipedia.org/wiki/Bak%C3%BC-Tiflis-Kars_demiryolu_ hatt%C4%B1

Baran, Zeyno (Autumn 2007); EU Energy Security: Time to End Russian Leverage, The Washington Quarterly, 30:4 pp. 131–144. p:137-143

Çeken, Hüseyin (2004); "Bölgesel Ekonomik Bütünleşme Sürecinde Avrupa Birliği ve Avrupa Birliği'nin Dünya Dış Ticaret ve Sermaye Hareketlerindeki Yeri ve Önemi" (24.11.2007); Dış Ticaret Müsteşarlığı Dergisi, Number:30, Year:9, Ankara, p.1-12. http://www.dtm.gov.tr/dtmadmin /upload/ EAD/Tanitim KoordinasyonDb /bolgesel ekonomik.doc

Davis, Elizabeth Van Wie and Rouben Azizian (August 2006); Islam, Oil, and Geopolitics: Central Asia After September 11, USA, Rowman & Littlefield Publishers, Inc.,

Deichmann, Joel et al. (November 2003); Foreign Direct Investment in Turkey: Regional Determinants, Applied Economics, vol. 35, no.16/10, pp. 1767-78.

Ergin, Feridun (2008); Uluslararası Politika Stratejileri, İstanbul Üniversitesi Yayını, Number: 2008, İstanbul.

Ertürk, Emin (2001); Uluslararası İktisat, Alfa/Aktüel Kitabevi, Bursa.

Fouskas, Vassilis K. (August 2007); Germany and the Passage from War to Peace in Eurasia, Debatte, Volume 15, Number: 2, p:444

Fried, Daniel (March 2008); United States and Turkey and Azerbaijan: A Strategic Partnership, The DISAM Journal, p: 30-34

Giovannini, Alberto and Colin Mayer (2005); European Financial Integration, Centre for Economic Policy Research.

Gözen, Ramazan (2006); Türk Dış Politikasının Avrupa Birliği'ne Doğru Dönüşümü, Uluslararası Hukuk ve Politika, Vol: 2, Number: 6 pp.1-16, p:10-11.

Huntington. Samuel P. (Summer 1993); The clash of civilizations? Foreign Affairs: 72. 3: p.42

International Monetary Fund, (April 2009); World Economic Outlook Database.

İktisadi Kalkınma Vakfı (2003); AB ve Türkiye-AB İlişkileri Temel Kavramlar Rehberi, İKV Yayınları, Number: 172, İstanbul.

İncekara, Ahmet (1995); Globalleşme ve Bölgeselleşme Sürecinde Nafta ve Etkileri, İstanbul Ticaret Odası, Pub. No:195-14, İstanbul.

İyibozkurt, M. Erol (1985); Uluslararası İktisat Teorisi, Uludağ Üniversitesi Basımevi, Bursa.

Joel I. Deichmann et al. (2003); Foreign Direct Investment in the Eurasian Transition States, Eastern European Economics, Vol.41, Number 1 / January- February 2003, p: 5 - 34

Jovanovic, Miroslav N. (2006); The Economics of International Integration, Switzerland.

Kocamaz, Sinem (2007); Avrupa Birliğinin Komşuluk Politikası Çerçevesinde Transkafkasya, OAKA, Vol:2, No: 4, p. 65-102, 66-68
Laçiner, Sedat (2006); Hazar Enerji Kaynaklari ve Enerji-Siyaset İlişkisi, OAKA, Vol: 1, Number: 1 p: 36-66.
Laruelle, Marle'ne (March 2004); The Two Faces of Contemporary Eurasianism: An Imperial Version of Russian Nationalism, Nationalities Papers, Vol. 32, No. 1, s:123
Moussis, Nicholas (2004); Avrupa Birliği Politikalarına Giriş Rehberi, Translator: Ahmet Fethi, Mega Press Kitabevi, İstanbul.
Norling, Nicklas and Niklas Swanstrom (September 2007); The Shanghai Cooperation Organization, Trade, and The Roles Of Iran, India And Pakistan, Central Asian Survey 26, 429–444 s: 434-435
Nurşin Ateşoğlu Güney (2007); Contentious Issues of Security and the Future of Turkey, Ashgate Publishing, Ltd., UK.
Özdemir, Volkan (2007); The Blue Stream Natural Gas Pipeline: Implications On Energy Security And Foreign Policy, OAKA, Vol:2, No: 3, pp.135-148.
Purtaş Fırat (2007); "Avrasya'daki "Yeni Büyük Oyun' Bağlamında Hindistan'ın Orta Asya Politikası", OAKA, Vol.1, No.2, p.79-81.
Sabır, Hasan (2002); "Gelişmekte Olan Ülkeler Arasında Ekonomik Entegrasyon: Mercosur Örneği", Dış Ticaret Müsteşarlığı Dergisi, Number:25, Year:7, p.95-109. http://www.dtm.gov.tr/dtmadmin/upload/EAD/TanitimKoordinasyonDb /gelismekte. doc (28.11.2007).
Şahinöz, Ahmet (2004); "AB-Türkiye: Ticari İlişkiler ve Gümrük Birliği", İktisat İşletme ve Finans Dergisi, Year:19, Number:219, p.28-46.
Şanlı Bahar (2008); "Ekonomik Entegrasyon Teorsi Çerçevesinde Avrasya Birliği'nin Olabilirliği", Atatürk Üniversitesi İktisadi ve İdari Bilimler Fakültesi Dergisi, Vol:22, No:1, p.19-26.
Seyidoğlu, Halil (1998); Uluslararası İktisat, Güzem Yayınları, İstanbul.
T.C. Başbakanlık Gümrük Müsteşarlığı, (2009); http://www.gumruk.gov.tr/Istatistikler/Default.aspx (29.05.2009)
Thomas W. Waelde (1996); The Energy Charter Treaty: An East-west Gateway for Investment and Trade, Kluwer Law International, p.107.
Türkiye Avrasya Dış Ticaret Köprüsü (20.02.2009); http://tuskon.org/faaliyet/detay.php?id=22 İstanbul, 04–05 December 2007
Türkiye–Avrasya Dış Ticaret Köprüsü (20.02.2009); http://www.tarafgazetesi.com.tr 17.09.2006
Uluslararası Ekonomik İlişkiler (20.02.2009); http://www.ekodialog.com/uluslararasi_ekonomi/uluslararasi_ekonomik_ iliskiler.html
Uyar, Süleyman (2000); "Ekonomik Bütünleşmeler ve Gümrük Birliği Teorisi", Dış Ticaret Müsteşarlığı Dergisi, Number:19, Year:5, Ankara, p.103-130. (Çevrimiçi)http://www.dtm.gov.tr/dtmadmin/upload/EAD/TanitimKoordinasyonDb/ekonomik%20b.doc (02.12.2007).
Uzunoğlu Sadi vd., (20.02.2009); "Avrasya Bölgesine Yönelik Gelişme Stratejileri ve Potansiyel Sektör Araştırması", http://canerekizceleroglu.trakya.edu.tr/kaynaklar/8.pdf s.11-14
Uzunoğlu, Sadi, Atakişi, Ahmet ve Yürük, Mehmet Serkan (30.03.2006); "Avrasya Bölgesinde Ekonomik Entegrasyonun Uygulanabilirliği Üzerine Bir İnceleme", Küreselleşme Bağlamında Avrasya Toplumları Konferansı, Uluslararası Atatürk Alatoo Üniversitesi, p.1-20. http://serkanyuruk. trakya.edu.tr/yayin/entegrasyon.pdf (03.12.2007).
UNCTAD, (2007); Trade and Development Report, New York and Geneva, s.89.
Yıldız, Mircan (1999); "Bütünleşme Biçimleri ve Avrupa Birliği", Dış Ticaret Müsteşarlığı Dergisi, Number:15, Year:4, Ankara, p.89-118. http://www.dtm.gov .tr/dtmadmin/upload/EAD/TanitimKoordinasyon Db / butun.doc (27.11.2007).
Yiğit, Mehmet and Sefer Şener (2006); Trade and Co- Operation with Turkey in the Black Sea Economic Cooperation From the Date of Its Establishment to the Present, 4.th International Business Administration Symposium, Karvina, pp.659-663.
Yüce, Mehmet and İbrahim Kalkan (20.02.2009); Ortalık Asya Devletler Birliği Fikrinin Tarihsel Gelişimi Ve İkinci Türkistan Forumu, p: 7 http://www.akademikbakis.org/sayi11/makale/myucekalkan.doc

# PURCHASERS' INVOLVEMENT IN SUSTAINABLE DEVELOPMENT: GREAT EXPECTATIONS AND VARIOUS REALITIES

**Fabienne FEL**
**ESCP Europe, France**

## ABSTRACT

*The main object of this paper is to determine to what extent Purchasing Departments in French companies do really implement sustainable development policies. In fact, many firms issue communications about their involvement in environmental and social strategies, and it appears that Purchasing Departments should be involved in such policies, because the weight of purchased parts and components is very heavy today. In order to provide a picture of the situation, we conducted a quantitative study among 250 French companies. The first results seemed disappointing, because less than 50% of the firms had already designed sustainable development purchasing strategies. However, we found a strong link between interest for sustainability and the size of the firms. After these first findings, we narrowed the sample to the 101 companies asserting that their purchasing policy included sustainability concerns. The second results were disappointing too, because most of these firms did not implement any real change in their purchasing policies, and did not even set to purchasers any target related to sustainable development. So, we narrowed once more our sample size to the 43 firms which were really incorporating sustainable development concerns into their policies. We found that these companies were conducting effective changes : they measure the performance of their suppliers more often than the others in our initial sample, they demand more ISO14001 certificates from suppliers based in low cost countries. The necessary changes linked to sustainability induce an increased number of concrete actions (more requests for new service providers, additional 'green' purchases, more frequent change of logistics channels in order to generate less pollution, a greater number of remote suppliers during call for tenders, as well as a greater number of severed contracts with suppliers who do not conform to the firm's sustainability regulations). Similarly, these 43 companies have a more positive outlook on the changes induced by sustainability, judging it to be an apt influence on supplier's offers, generating a partnership spirit and reducing global costs of Purchasing.*
*So, it appears that there is a wide gap between firms using the concept of "sustainability" as an advertising argument, and firms really implementing changes in order to promote sustainable development among their own departments, and along the supply chain.*

***Keywords****: Sustainable Development; Purchasing ; Change*

## INTRODUCTION

The purpose of the present study is to investigate whether sustainable development policies conducted by many companies today are taken into account by Purchasing Departments. According to Preuss (2007), the question of the involvement of purchasers in sustainable development policies is a relatively novel research question. There are lots of communications from firms in professional reviews, but little academic research. Moreover, major academic papers dealing with purchasing and sustainability, like those of Preuss, are focused on environmental aspects, and do not deal with the other dimensions of sustainable development, which are social and economical concerns. So, our research question is to determine if purchasers are really involved in sustainable policies, and in this case, if these policies induce real changes in terms of bought products, and in terms of choice of cleaner or more socially responsible suppliers.

This article proceeds in the following way: first, we review the literature about purchasing recent evolutions, and discuss the role that purchasers could play in order both to support the sustainable development policy of their own firm, and to promote sustainability among their suppliers. In a second part, we present our data collection method. Thirdly, we provide the main findings of our research, based on data collected among 250 French companies. As a conclusion, we propose directions for further researches, such as the study of best practices implemented by "citizen firms", or the way they implement them.

# LITTERATURE REVIEW

Sustainable development is defined as development that "meets the need of the present without compromising the ability of future generations to meet their own needs" (Brundtland Commission, 1987). Today, many firms are implementing sustainable development policies, driven by two major forces (Hall and Vredenburg, 2003) : first, there is social and legal pressure to reduce the environmental and social consequences of industrial mass production and consumption. Then, "citizen firms" can aim at increased sales, improved corporate image and enhanced competitiveness (Porter and van der Linde, 1995 ; Pujari and al., 2003).

## The Strategic Role of Purchasing

Nowadays, companies are outsourcing more and more activities, which mean that they are buying an increased share of products and services. As shown by Lysons and Gilingham (2003), the percentage of bought components in the total cost price of Western products has risen from 40 to 65% (on average) over the last twenty years, because manufacturers are relying more and more on outsourcing, particularly from low cost countries

Therefore, the purchasing function has gained a more strategic position in recent years (Hurkens and Wynstra, 2006). Another explanation for the strategic role of purchasing today is the earlier involvement of suppliers in new product development projects, which aims both to reduce time to market of new products (Fel, 2001), and to expect a growing part of innovation from suppliers (Lamming, 1993). So, purchasers have to widen the scope of their function, by joining earlier on new product development teams, and by setting long term relationships with their main suppliers: many innovations belong to these suppliers, which means that buyers and sellers are linked for long periods of time. As a consequence, one of the main functions of purchasers is to manage these long term relationships.

These evolutions induce the need for real teams of purchasers, able to manage all aspects of the function, from the search for new suppliers to contracts signing and management of the suppliers' performance, in coherence with firm strategy (Trent and Monckza, 2003 ; Loppacher and all, 2006), and the strategic role of purchasing increases when this function is centralized (Johnson and all, 2002).

## The Necessary Involvement of Purchasing in Sustainability

As a consequence of the rising percentage of bought parts and components, the environmental performance of a new product is widely determined by supplier inputs (Preuss, 2005). Regarding sustainability, purchasers face two types of risks:

- Risks related to the product are these of buying components that do not match the environmental criteria defined by the firm in its sustainability strategy. This risk is limited in some sectors by laws about products that can damage public health or environment (European guidelines RoHS or REACH, for instance).

- The "supplier risk" is working with suppliers who use polluting production methods, or fail to respect basic labour rights ; this last risk is greater today as, increasingly, firms are trading with suppliers located in low cost countries, where workers' rights are not always respected. Some well-known problems, like the ones of Nike or Gap, whose Chinese or Indian suppliers made children work, have widely and publicly illustrated this risk.

But regarding sustainability, purchasers face also some opportunities :

- For Preuss (2005), from an ecological point of view, opportunities are purchasing greener parts or components, and then fostering ecological innovation among suppliers.

- The increasing involvement of purchasers in new product development teams (Fel, 2001) is also an opportunity for eco-conception : as most firms implement concurrent engineering in order to reduce time to market of new products, Purchasing is involved at an early stage in the design of new products, and can play a role in promoting the design (and not only the purchase) of more ecological parts or components.

- Further more, we can enlarge the idea of Preuss, by taking into account the fact that purchasers are not only responsible for the choice of the product, but also for the choice of the supplier, and for the management of its performance. According with Green and al. (1996), if a firm adopts social standards, the purchasing function can be used to transfer them to suppliers. So, purchasers can induce suppliers in improving their social performance, as well as their environmental performance.

First studies about purchaser's involvement in sustainable development (Bruel and al., 2007) highlight major differences among the organisations surveyed, and show Supplier Performance Management as the main process impacted. For Preuss (2007), purchasers' involvement in ecological innovation could be greater, particularly in SME.

# METHODS

In order to identify the actual practices of Purchasing Departments in terms of sustainability, we directed in 2006 a research project which involved 250 companies. A questionnaire was sent by e-mail to about thousand Purchasing Managers in French companies of all sizes and sectors. We received 261 answers. Some data were missing in some questionnaires, and we at the end obtained 244 usable answers, which means a return rate of near 25%. This rate is very high for this kind of study, and seems indicative of the interest of many companies for this theme.

We collected data about firms, their sustainability policies, and their motivations to implement sustainable development policies; we collected more precise data about real actions implemented by Purchasing Departments, about the existence of progress key indicators, about the management of suppliers performance, and about the outlook of Purchasing managers on sustainable development.

After the initial work of our student (Roiron, 2006), we worked further on the data basis, using SPSS 10.0.

Following our statistical analyzes, we worked successively with three samples: the first sample was comprised of all respondents. In order to understand what firms really do when they assert dealing with sustainable development, we removed from this first group companies which did not implement any sustainability purchasing policy. This second sample was comprised of 101 companies. Then, in order to analyse practices in Purchasing Departments which really follow sustainable objectives, we built a third sample, with only 43 companies, and focused on this last group.

# RESULTS AND FINDINGS

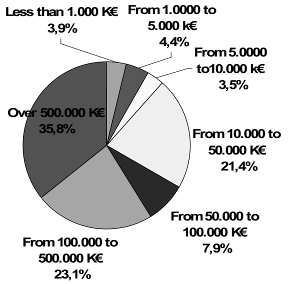
## Definition of the Initial Sample

The respondents were for the most part Purchasing Managers (52%) or Purchasers (35%); The majority came from industrial firms (75%), rather than service companies (25%).

A first and surprising finding was the over-representation of industrial firms in the sample, because there are more service firms than industrial firms in France. But, as industrial firms are more concerned with environmental problems than service companies, and as the most developed pillar of sustainable development is the environmental one, we concluded that, although our sample cannot be considered as statistically representative of French firms, it can be viewed as a representation of firms that tend to really implement sustainability, or that have ideas about this concern.

Therefore, because of the over-representation of industrial firms in the sample, we ran no comparison between industrial sectors, nor between industry and services.
All business sizes were represented, from SMEs (almost 30%) to large companies (37% of the firms in our sample employ over 5, 000 people), as shown in Figure 1.

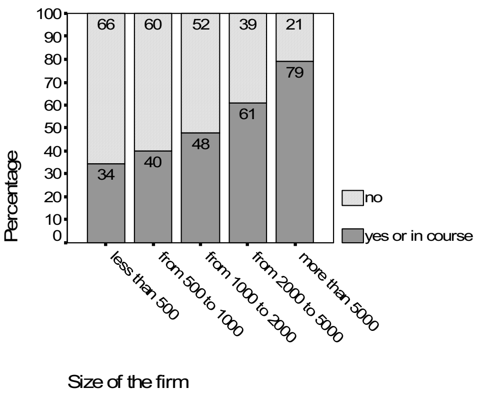
**Figure 1 : Turn-over of the sample's firms**




## First Results

56% of the firms in our sample asserted that they already integrated sustainability in their purchasing policy (41%), or were in the process of doing so (15%). Unsurprisingly, it is within the largest companies that this initiative is the most advanced, as almost 80% of the larger firms replied affirmatively. As shown in figure 2, there is a correlation between company size and the integration of sustainability in purchasing policies, Khi-deux test being significant above 99%.

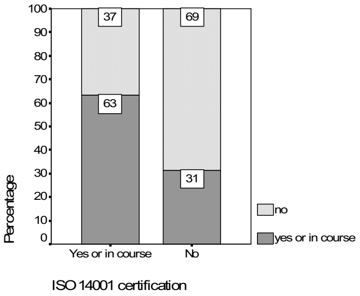
**Figure 2 : Involvement of Purchasing in Sustainability**



Quite logically, a correlation also exists between the integration of sustainability in companies purchasing strategies, and their ISO14001 certification, as shown in figure 3 (Khi-deux test is significant above 99%) : 63% of certified companies or those currently being certified have integrated sustainability into their purchasing strategy, compared to less than half of those who do not seek certification. However this also signifies that 37% of ISO14001 certified companies have not taken into account new demands linked to sustainability in their purchasing strategies, despite the fact that their company is deeply concerned with this issue. It seems then that the changes linked to the implementation of sustainability do not systematically affect the purchasing departments.

Beyond this well-advertised integration of sustainability into purchasing strategies, we sought to gage the extent of the change in the function of Purchase Departments.

**Figure 3 : Involvement of Purchasing in Sustainability**



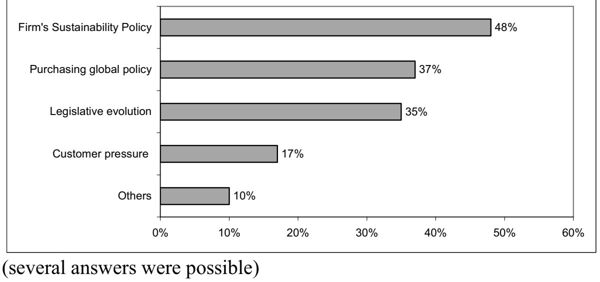

# Factors that induce the Change

In order to understand the factors leading to change, we narrowed our initial sample to firms claiming that they have integrated sustainability into their purchasing policies. This second group is comprised of 101 companies

Amongst these companies, it is clear that the change to Purchasing is rather induced than constructed. In 88% of cases, sustainability had been introduced into purchasing policy following the receipt of a letter from general management, or the release of a purchasing ethics chart, also drawn up at the request from top management. More generally speaking, it is usually under pressure that this policy is adopted by Purchasing Departments: In the first instance, pressure from top management, who defines the company's Sustainability policy (48% of cases), then statutory or legislative pressures (35%) and finally customer pressure (17%).

Figure 4, which illustrates these figures, could lead us to conclude that in 37 % of cases the Purchasing manager played an important role in the definition of the new strategy, but these figures are put into perspective when we consider that there were several possible answers to the question: thus, out of the 51 companies which indicate their purchasing policy as a cause of change, 29 also include the company's general strategy, and amongst the remainder, 18 state legal pressures or clients demands.

**Figure 4** : **Reasons for Implementing Sustainability Policies in Purchasing**




(several answers were possible)

Amongst the 101 companies which claim to have integrated sustainability into their purchasing policies, we tried to identify those which really look for changing this concern into concrete actions. The criteria used to identify these firms was the existence or not of indicators dealing with environmental or social concerns. Once again, the results seemed disappointing: only 48% of the respondents have to reach objectives dealing with sustainable development, and the definition of such objectives is just a project for 15 %. So, it appears that 36% of firms that display sustainability purchasing policies do not have any requirement related to this concern, and do not evaluate purchasers using their results in this area.

Literature has shown that all management objectives (in terms of cost reduction, quality improvement, ...) have to be regularly reviewed to be an efficient motivation tool, to allow for progress and to ensure that everyone in the organization makes decisions and follows the lines of action consistent with the firm's strategy.

This is done in only 43 firms in our sample (this means 89% of the 48% described above). In these companies, purchasing managers and purchasers have to reach real targets dealing with environmental and/or social concerns, and these targets are regularly reviewed, at least once a year. So, we decided to focus on these 43 companies, which seem to be implementing real sustainability purchasing policies, and to create a third sample with these firms.

## Real Changes

The firms in the third sample have taken real actions in order to implement sustainable development in their purchasing policy, and to promote sustainability among their suppliers. As shown in figure 5, the first action area is to require more environmental and social standards from suppliers based in Low Cost Countries (84%), by requiring ISO14001 certifications on the one hand, and respect of social standards on the other hand (these firms require from their suppliers signing international standards, as Global Compact, or signing "home made" supplier charts, which include social standards).

As a consequence, our research shows that the first issue in terms of sustainable purchasing seems to be the management of the suppliers performance in terms of environment and social standards respect.

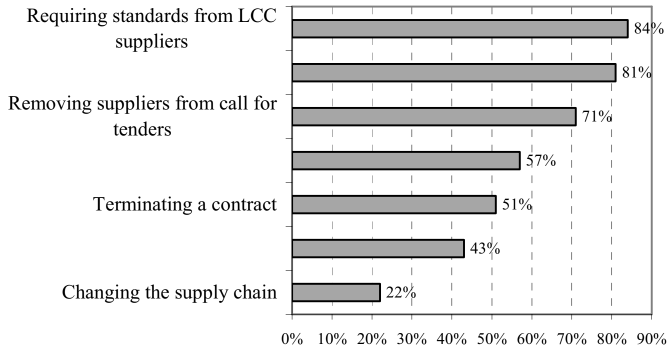
The second change deals with purchasing "new services", which means training and consulting services in the sustainable development area (81%). As shown recently by Bruel (2009), purchasers have still difficulties to manage the concept of sustainability, because of their lack of training in this area, and because of the very deep complexity of sustainable development, which includes both environmental and social concepts, with a wide range of different labels and standards (Global Compact, SA 8000 standard, EMAS, ISO 14001 standard...). So, our research shows that firms really involved in sustainable purchasing strategies use training and consulting means to reach their targets.

The third important action implemented by companies of our final sample is to remove, during the call for tenders step, suppliers, which do not respect environmental or social firm's requirements (71% of the sample). This finding is close to the first one and coherent with it : quite logically, firms wanting to work with suppliers which respect environmental and social standards do not include "bad" suppliers during call for tender. This seems easier to do than to terminate an existing contract (however, 51% of the respondents already terminated such a contract for sustainability reasons).

All these findings underline that these 43 firms focus their effort on purchasing process, including the selection of "good" suppliers and the management of their environmental and social performances (which they do with the help of consultants and with purchasers training), rather than on the products themselves : the rate of firms buying "greener products" is lower (57%) than the previous ones.

Finally, some firms seem to include Purchasing Departments in wider actions, which have an influence on the purchasing policy : 43% have changed part of their technology for a cleaner one, and 22% have modified their supply chain, both in order to reduce transportation and pollution, and to buy products made by firms located in countries where work laws are always respected.

**Figure 5 : Real Changes in Final Sample**

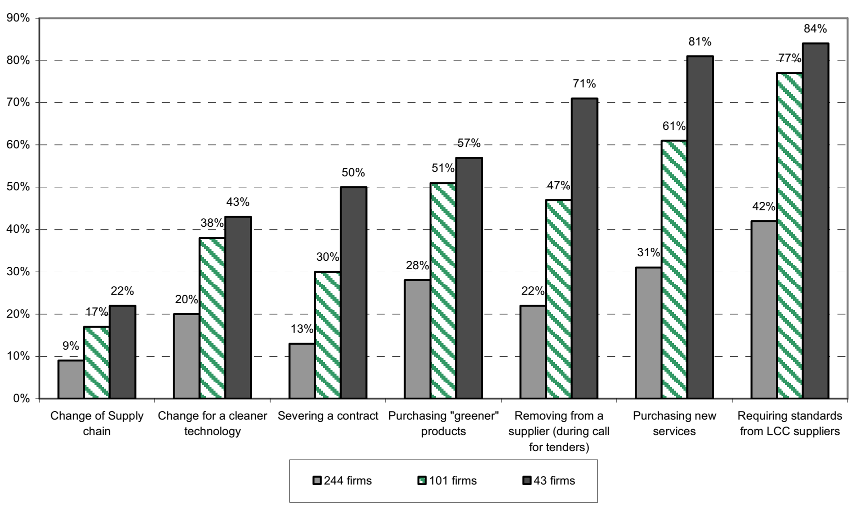



(several answers were possible)

## A wide gap between firms

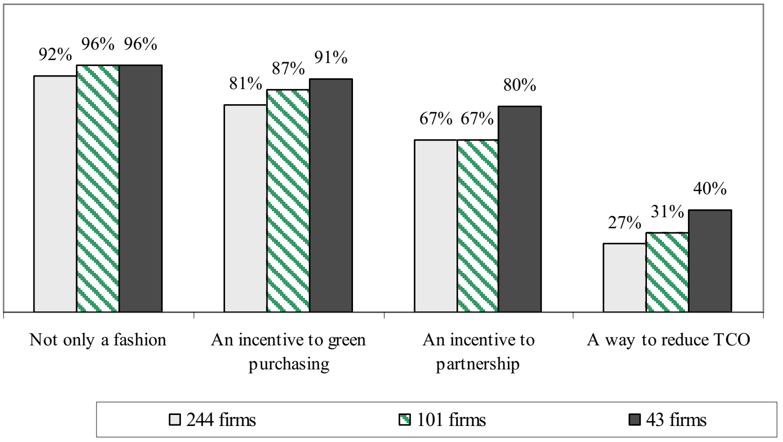
At the end, we have built three different samples: the first one, with all respondents; the second one, with firms claiming that they are implementing sustainable purchasing policies; the third one, including only firms with real and regularly reviewed sustainable purchasing targets. The comparison between these three samples shows that the more firms are really involved in sustainable purchasing policies, the more they implement real actions, what seems an evident conclusion (Figure 6).

**Figure 6 : Actions implemented by firms in each sample**




More interestingly, our comparison also evidences that, the more firms are really involved in sustainable purchasing policies, the more they create a positive perception of sustainability, in terms of the need for sustainable development (as an opportunity, and not as a fad), in terms of incentive to green purchasing, of incentive to supplier partnership, and in terms of reduction of the total cost ownership. (Figure 7)

## Figure 7 : Perception of Sustainability




These last findings underline that most respondents have a positive perception of sustainable development. Of particular importance is the last conclusion, which highlights that firms really implementing sustainable development in their purchasing strategies are more convinced than others that sustainability is a good way to reduce Total Cost of Ownership : sustainable development is easier to implement when it can contribute to earn profits, by increasing the turn-over of the firm, or by reducing costs, than when it appears as a source of additional expenses (Reynaud, 2005). So, perception of sustainable development as a cause of costs' reduction by firms really implementing it, allows us to hope that other firms will implement it, -even for financial reasons- and hence contribute to promote environmental and social concerns along the supply chain.

# Conclusion

Unsurprisingly, we have shown that there is a strong link between sustainable purchasing policies and the size of companies: as usual, big companies are the first ones making great progress (as with quality improvement in the 80's, for instance), and smaller companies join later the evolution.

Our study has shown that sustainability's necessity in purchasing policies is still today not widely taken into account: less than half of respondents are implementing sustainable purchasing policies. Amongst those who claim doing it, less than half really measure and review the performance of their Purchasing Department in terms of sustainability. Only 43 companies in our initial sample (less than 18%) seem to really implement sustainable purchasing policies.

So, we have defined a typology of companies about involvement of Purchasing Function in sustainable development: companies removed from each successive sample represent three ways of dealing with sustainable development. The first one is ignoring this concern (firms removed from the second sample). The second one is asserting that sustainability is taken into account, but without any requirement from purchasers in this area (firms removed from the third sample). The third one is really involving purchasers in sustainable development, which induce more concrete actions (firms of the third sample).

But the positive perceptions and results of companies of the last sample lead us to think that this attitude can extend to others firms in the future. Firms that really implemented sustainable purchasing policies, with actions devised to avoid working with "uncitizen" suppliers, and to deal with firms following environmental and social issues, have realized concrete actions, and seem satisfied with their results.

It appears that the first step of progress is managing the purchasing process, from the choice of suppliers to the management of suppliers' performance, with the need for purchaser's training and help of consultants. A second level for more mature firms is to integrate the Purchasing function in larger changes, such as changes of technology or modifications of the supply chain, particularly to promote near-sourcing, with lesser transportation needs, less pollution, and the certainty that country's laws comply with basic labour standards.

Our paper presents some limits: first of all, some of the proposed results and findings cannot be generalized (the composition of the initial sample is biased by the over-representation of industrial companies). Another limit is linked to our methodology : by conducting a quantitative survey, we have provided a picture of the situation, but we cannot explain the implementation methods of sustainable purchasing in firms which really try to make progress in this way. The next steps are to list best practices in these firms, and to understand on the one hand, how they are really linked to sustainable development general policy of the firm, and on the other hand, how they can be successfully implemented. These issues will be the subject of our next studies.

## REFERENCES


Bruel O, Menuet O. and Thaler P., (2007), *European Sustainable Procurement Survey*, HEC Paris

Bruel (2009), *4th Sustainable Procurement Benchmark Report,* HEC PARIS

Brundtland Commission (1987), *Our Common Future*, Oxford University Press

Fel F., (2001) *Les trajectoires de mise en oeuvre des démarches d'ingénierie concourante*, Thèse de Doctorat, Paris X Nanterre

Green K., Morton, B. and News, S, (1996), 'Purchasing and Environmental Management : Interaction, policies and opportunities', *Business Strategy and the Environment* 5 (3), 188-197

Hall K. and Vredenburg H, (2003), 'The challenges of innovating for sustainable development', *MIT Sloan Management Review*, 45 (1), 61-68

Hurkens K. and Wynstra, J.Y.F. (2006)., 'The concept "Total Value of Ownership" : a case study approach', *The Journal of Supply Chain Management, 42*(1), 27-37.

Johnson P.F., Klassen R.D, Leenders M.R and Fearon H.E., (2002), 'Determinants of purchasing team usage in the supply chain', *Journal of Operations Management*, 20(1), p.77-89

Lamming, R,(1993), *Beyond Patnership : Strategies for Innovation and Lean Supply*, Hemel Hempstead, Prentice Hall

Loppacher J., Luchi R., Cagliano R and Spina G., (2006), 'Global Sourcing and Procurement Strategy : A model of Interrelated Decisions', *Supply Chain Forum International Journal*, vol7, n°1, p. 34-46

Lysons and Gillingham (2003), *Purchasing and Supply Chain Management*, 6th edition, Prenctice Hall

Porter M. and van der Linde C., (1995), 'Green and competitive: Ending the stalemate', *Harvard Business Review*, Sept.-Oct., 120-133

Preuss L., (2005), *The Green Multiplier : a Study of Environmental Protection and the Supply Chain*, Basingstoke : Palgrave

Preuss, L, (2007), 'Contribution of Purchasing and Supply Management to Ecological Innovation', *International Journal of Innovation Management*, vol. 11 (4), p. 515-537

Pujari D., Wright G. And Peattie K, (2003), 'Green and competitive : influences on environmental new product development (ENPD) performance', *Journal of Business Research*, 56(8), 657-671

Reynaud E. (2005), *‘Stratégie et Développement durable : à la recherche d’un compromis’*, Working Paper n° 744, Université Paul Cézanne, IAE, Aix en Provence

**Roiron Lucie, (2006), *Les achats et le développement durable dans les entreprises françaises privées*, thèse professionnelle de MS, ESCP-EAP, France**

Trent R.J. and Monckza R.M. (2003), ‘International Purchasing and global sourcing – what are the differences?’ *Journal of Supply Chain Management,* 39 (4), p.26-37

United Nations. (1987).*Report of the World Commission on Environment and Development,* General Assembly Resolution 42/187

# POLICIES AND STRATEGIES FOR THE PROMOTION AND ATTRACTION FDI IN SERVICES

**Vesna Babić-Hodović**
**Eldin Mehić**
**School Of Economics And Business Sarajevo, Bosnia-Herzegovinia**

## ABSTRACT

*In the paper we presented results of the research, realized with the goal to test main determinants influencing on FDI stock in services, in order to propose policies and strategies for promotion FDI in services for transitional countries, precisely CEE countries. Some of the conceptual issues identified under FDI in services we started with are: 1) What are the most important determinants of FDI in services in CEE? 2) Which policies and strategies for promotion and attraction FDI in services developing economies – CEE could use?*

*The dependent variable used in this paper is the FDI stock p/c – NACE 1-digit into the service sector for each observed CEE country in the period 1997-2007. In the case of our sample of countries, we have chosen from the pool of traditional and institutional-related determinants in the literature, and based on the availability of relevant indicators, the following set of possible FDI determinants have been chosen.*

*Using the set of data for CEE countries over ten years, empirical analysis is conducted by the regression assessment of panel data. We estimated OLS with panel-corrected standard errors (PCSEs) using Prais-Winsten to take into account the AR(1) process. Based on results of research we created proposal for sets of policies and strategies acceptable for service sector and attracting FDI in services.*

***Key words:*** *services, FDI, CEE countries, institutional framework*

## INTRODUCTION

Foreign direct investments (FDI) phenomena are crucial elements in the analyses and recording development of modern economy. Their role in globalization is unquestionable. Consequently, the countries generating most FDI are in the same time the leading ones.

Exploring FDI from theoretical and practical point of view is the main point of evaluating the development of specific industrial and service area, and the analyses of development of transitional countries. This is specifically important if one takes into consideration the fact that economic development of transitional economy significantly depends on the foreign capital inflow. That is the reason why the relation between FDI and the level of economic development is very complex and multifaceted. Knowing that FDI inflow affects economic development and that the level of economic development and infrastructure has a positive influence on the attractiveness for the FDI, sometimes it is very hard to find out the quality and direction of influence.

On the other side, the growth of service sector in the global economy has been accompanied by a growth in its share in the world transactions, as well as FDI. Some of the studies have argued that the introduction of services does require a different approach, the other has had opposite attitudes. But, as far as we know, there are no studies from or of a developing country. Services characteristics have implications for how to trade can occur or how to transfer them between the countries. Their intangibility and nonstorability means that in order to become tradable, services have to be applied to, or embodied in objects, or information flow, or persons. Thus, for trade to occur, the means of transporting services often have to be able/permitted to cross national frontiers. This makes international transaction in services more complex conceptually than international transaction in goods. These characteristics differentiate services from goods and this has implications on the determinants of FDI in service sector.

That was the reason why we started to research the level, structure and factors influencing FDI inflow in services of CEE countries, and effects of foreign direct investments in services. The goal of the paper was to test effects of growing level of FDI in service sector, and in the same time factors, most influence on the level of FDI inflow. Eventually we wanted to find out most important factors, countries can implement in the policies and strategies for the promotion and attraction FDI in services. According those elements, in the paper, policies and strategies for the attraction of FDI stock would be created based on econometric analyses, which will include institutional-related determinants.

The paper is structured in the three main parts: first of them discussing services characteristics, factors influencing FDI inflow, specifically in service sector, second of them discussing research methodology and result we have got, and finally third, stressing conclusions and recommendation for the future research.

# SERVICES CHARACTERISTICS AND FDI

## Services characteristics

The growing internationalisation of services has led to a vast literature and some of the fiercest debates on critical issues regarding trade and investment in services. The increasing world trade in services can be partly attributed to the greater extent of liberalisation (unilateral, bilateral and multilateral) undertaken by different countries and partly to the technological advances that has enabled higher tradability of services. Development of a greater barriers of discreet „service-oriented“ products (such as software and interactive databases that can be easily accessed) has also been a key as it has created an effective medium for packaging and distributing storable knowledge and information.

Bhagawati (1984) argues that services can be divided into two categories: first, those that necessarily require the physical proximity of the user and the provider; and second, that do not essentially require this though it may be useful. First group specifically influenced by some of the service specific characteristics, stressed by Hill (1997), Berry (1989) Kotler (1997), Langeard, Bateson, Loveloc and Eiglier (1981), Gronroos (2007): intangibility, presence of customers at the service process, intangibility, perishability, absence of ownership and heterogenity. The other group is less problematic, from this point of view, and it could analyze more or less as the goods' transaction.

The basic characteristics of services on which most of the classifications are based are: non-transferability and non-storability. The other associated characteristics of services that need to be noted are that services are heterogenous and flexible in production and imperfect competition is highly relevant for services.

However, Bhagwati (1985) further argues that services for which physical proximity is inessential i.e. long distance services, are on a rise due to technological progress (service like banking and insurance fall under this category, as well as infrastructural and IT services). Such characteristics make international transaction in services as well as FDI in services more complex conceptually than in international transaction and FDI in goods. That is the main reason why is important for host countries to find out are there the same influential factors attract FDI in service sector, as well as in the manufacturing sector.

## Foreign direct investment in services

Looking at the FDI development and its influence on globalisation, the main purpose of most of the analyses is to outline those aspects and considerations which are relevant to any less developed economy in the promotion and attraction of FDI. The main concern is really with host-country characteristics which can be identified on the basis of the current and potential development level of that which to attract FDI, in our case to attract FDI in services.

Factors and conditions that are important determinants of FDI inward can be divided into two categories:

a) firm and industry-specific determinants, those factors induce the firm to invest abroad or at least offer an advantage or support for the internationalization of production, including such firm-specific or owner-specific factors such as managerial skills, product differentiation, technological lead and know-how; large size and market power, marketing and organizational expertise, R&D capacity, etc.
b) host-country specific determinants: factor conditions, human resources, physical and natural resources, climate, location, unskilled labour and capital, but also advanced factors that are created such as modern infrastructure, universities, and highly skilled labour.

For the purpose of this paper, it is host-country specific characteristics which are more important as the influence factor on the FDI inflow in the country. The attractiveness of a country/locality as investment destination depends on the general development level of the country/locality. TNCs look for countries which offer the best facilities for the least cost, but for the country it is important to find out correlation between the factors and the level of FDI inflow, in order to stress and improve development of those factories, during the process of FDI promotion. Often small countries do better to attract market-seeking FDI within the context of regional cooperation i.e., countries of CEE or SEE group.

## Theoretical framework and literature review

FDI has grown faster than the global output and trade over the last two decades. This has given rise to a number of theoretical and empirical studies that have investigated its determinants and impact on the host economies. However, much of this literature has focused on FDI in manufacturing and very few studies exist for the service sector. This is an important lacuna in the literature since FDI in services has been found to grow even more rapidly than FDI in manufacturing.

Starting from these specific characteristics of services, some of the conceptual issues, identified under FDI in services are:

- *What are the most important determinants of FDI in services?*
- *What are the implications for policies and strategies to attract FDI in services for developing countries?*

Studies differ with respect to the framework used for service FDI. Some studies have applied theories that are applicable for FDI in goods (Chanda 1997, Schorath, and Korth 1988, Gray and Gray) while others have applied trade theories to service FDI (Helpman 1984, Marrkusen et al 1996).

Of the various theories put forward to explain FDI, Dunning's eclectic paradigm of international production (Dunning 1981) has been used by many studies (e.g. Chanda 1997). The theory combines the traditional theory of factor endowements with the theory of economic organisation. According to this theory, the extent, pattern and growth of value added activities by TNCs depend on their competitive advantages relative to local firms. These advantages include ownership, location and internalisation advantages (OLI), i.e. the propensity for a firm to invest in foreign locations depends on a combination or any one of the following three elements: a) its ownership of core competencies or specific intangible assets that enhance competitive advantage; b) locational advantages that would derive from a transfer of operations onto a new region; c) internalisation advantages that may accrue to such investing firms.

Dunning (1989) identifies different ownership, location and internationalisation advantages of services transnational corporations. Rugman and Verbeke (1992) propose that a firm can successfully undertake direct investment abroad if it possesses some asset advantages, which may be location-bound or non-location bound. In case of service corporations such advantages consist of property rights of management, marketing and product innovation, exclusive or favoured access to input and product markets, access to technology and information, economies of joint supply in production, marketing, etc.

Engagement in foreign production would be motivated by the perception of companies about their best interest to combine, transferable advantages with some less immobile factor or some of locational advantages, in the form of tariff barriers, large markets, availability of resources at low cost, etc, in the case of goods, or input costs, infrastructural provisions, government regulation, size and character of local market, customers, competitors etc. in the case of services.

In order to undertake FDI successfully, firms must be able to internalise their ownership advantages, since need to internalise arises from transaction costs, which are the result of imperfect nature of product and technology market (Hymer 197, Buckley and Casson 1976, Vernon 1966) and/or imperfections in financial markets (Rugman 1982). Without the advantages of internalisation, FDI might be replaced by exports or licensing.

The other group of theories, the ones apply trade theory to FDI in services insist on the fact that theory of FDI follows in many respects the theory of international trade. There are two distinct patterns of FDI: the "vertical" or inter-industry pattern, often found in FDI from developed countries (Helpman 1984) and "horizontal" or intra-industry, where relatively specific advantages within given industries between developed countries are exchanged. Most FDI is of the latter type.

Markusen et al (1996) show different type of relation between size of countries and type of FDI: a) vertical multinationals dominate in production when countries differ significantly in relative factor endowments, but are similar in size; b) horizontal multinationals dominate between similar countries, both in size and available factors.

The two theories of FDI in services therefore differ with regards to their explanation as to why FDI rather than trade occur and what kind of FDI occurs. There are certain characteristics of FDI in services that merit exclusive attention, which are not covered in either of the two theories: how do FDI in services is possible transnationalise and what factors previously influence on FDI inflow and atractivenes of countries in the process of internasionalisation of services?

The available econometric studies of service industries are all of financial industries. Yamori (1998) analyzes Japanese finance industry FDI flows into 39 countries 1990-9. Miller and Parkhe (1998) study the determinants of US banks' asset in 32 countries. And finally, Moshiran (1997) examines determinants of FDI stocks in the US insurance industry, using time series data.

Market size is suggested as an important determinant of finance sector FDI, by both Yamori (1998) and Moshiran (1997), using GNP per capita and wealth as proxies for market size. Miller and Parkhe (1998) find a similar result for the banking sector, where host countries with a greater sum of deposits get more banking FDI. Market growth, however, appears to have a negative impact on FDI, as judged by the negative relationship between GNP change and FDI found by Yamori.

## Sectoral composition of FDI in CEE

Looking at the sectoral composition of FDI, the CEE countries (outside the CIS and SEE countries) are characterized by a high penetration of FDI in services and infrastructure services, e.g., telecommunications, water, electricity, and relatively smaller amounts of FDI (in global comparison) in business services and research and development (R&D).

This issue is due to the fact that, in many countries, FDI orientation toward the services is related to the very significant liberalization of direct investment regime and removal of discriminatory barriers for foreign investment in some of services sector (banking and financial sector specifically). On the other side, growing FDI in services was influenced by the following:

- Financial services industry globalization resulted in the growing competition between different non-financial sources of credits and financial services (especially on the insurance market) which, in turn, led to the continuing consolidation of banking system on the mature and emerging markets (Roldos, 2001) and even by the need to open new markets according to the Ansof model of development strategy.
- Foreing services companies' interest in emerging markets is conditioned by the possibility to use effects of economy of scale or scope derived from the technological advantages and the advantages of entry in the early phase of product or service life cycle.
- Many services companies guided by the language and cultural connections developed their activities regionally and focused on the specific region (CEE countries...)

The growing presence of foreign service institutions is particularly notable in the financial systems of „emerging markets" or transitional economies (TE). Based on analyses of regulation the FDI area we can see that many emerging markets have reduced barriers for export and investment since 1990 in order to improve their own service efficiency and become part of organizations with diversified global portfolio (Roldos 2001).

As discussed earlier, though a vast literature is available on the determinants of FDI in goods, very few empirical studies exist on the determinants of FDI into services. Among them are UNCTC (1993), Fukao and Ito (2000), Buch (200) Chanda (2000) and Raff and Ruhr (2001). But, most of these studies are mainly undertaken for some of the prominent producer services, e.g., banking and insurance.

Drawing from various theories, for example, eclectic paradigm, (Dunning 1988), internalisation theory (Buckley and Casson 1976), oligopolistic reaction (Knickerbocker 1973), cultural distance (Hofstede 1980, Kogut and Singh 1988) and firm strategy (Kogut 1988, Porter 1990), as well as Markusen (1989) and EBRD indicators, in our research we have found significant corellation between FDI inflow and the next variable, explained in the next section:

a) Overall transition indicators
    a. Price liberalisation
    b. Competition policy
    c. Banking reform and interest rate liberalisation
    d. Securities markets and non-bank financial institutions

b) Infrastructure reform
    a. Telecommunications

Based on previous literature framework we have tested next hypothesis:

Hypothesis 1: There is positive significant influence of each of next factors: price liberalisation, competition policy, banking reform and interest rate liberalisation as well as securities markets and non-bank financial institutions to the level of FDI inflow in service sector.

Hypothesis 2: There is positive significant influence of infrastructural reforms, specifically reforms in telecommunications on the level of FDI inflow in service sector.

Hypothesis 3: There is significant influence of GDP, inflation and salaries on the level of FDI inflow in services sector, as well as in manufacturing one.

## Modelling and Data

The sample of countries for analysis consists of eight transition countries that acceded to the EU in May 2004 (the Czech Republic, Poland, Hungary, Latvia, Lithuania, Estonia, Slovenia and Slovakia). The empirical framework employed in the analysis involves the use of a single equation model for testing the relationship between FDI in service and institutional infrastructure. The model regresses the FDI data on a measure of institutional development, and a set of control variables. The dependent variable in the paper is FDI stock per capita[2], NACE 1-digit in the service sector for each observed CEE country in the period 1997-2006. Most FDI data were taken from the Vienna Institute for International Economic Studies (WIIW) database.

In recent years, multinational enterprises increasingly focus on ‘‘created assets’’ (Narula & Dunning, 2000) including knowledge-based assets, infrastructure and institutions of the host economy. Legal, political and administrative systems tend to be the internationally immobile framework whose costs determine in international attractiveness of a location. Institutions affect the capacity of firms to interact and therefore affect the relative transaction and coordination costs of production and innovation' (Mudambi & Navarra, 2002: p. 636). Thus, institutional environment can be a significant location determinant in attracting FDI. In this paper, institutional development was measured based on a series of indicators of the transition process progress constructed by EBRD: Competition policy (CP), Banking reform & interest rate liberalisation (BR), Securities markets & non-bank financial institutions (SM), Overall infrastructure reform (OI) and Telecommunications (T). Indices can take values from 1 to 4+, whereby a higher index denotes getting closer to norms of developed market economies.

In some cases, there is some collinearity[3] between the indicators of institutional development, largely because progress in various elements of the transition process often occur simultaneously, if unevenly, in particular countries. For this reason, we test hypothesis by estimating a series of equations, one for each institutional development index.

In order to ensure that we are able to obtain unbiased econometric estimates, our analysis controls for a number of factors that the existing literature has identified as important determinants of FDI. The influence of institutional development on FDI stocks, our analysis controls for a number of factors that the existing

[2] There are several advantages in working on FDI stocks rather than flows. First, foreign investors decide on the worldwide allocation of output, hence on capital stocks. Second, stocks account for foreign direct investment being financed through local capital markets, hence it is a better measure of capital ownership (Devereux and Griffith, 2002). Finally, stocks are much less volatile than flows which are sometimes dependent on one or two large takeovers, especially in relatively small countries (Quere et al, 2005). Data have been agregate as the result of authors' calculation from Vienna Institute for International Economic Studies (WIIW) database.

[3] Correlations matrix is not presented due to space limitations

literature has identified as important determinants of FDI. A set of control variables is intended to capture those structural characteristics of the host economy that may attract FDI. Most empirical studies on FDI in transition countries suggest that most enterprises in these countries invest in order to find new markets for their products/services, regardless of the industry the investment is made in (Lankes and Venables, 1996). A larger market represents a greater number of potential customers, which may lead to profit growth. Our model includes GDP per capita which is a proxy for the purchasing power of local consumers (local demand) and market size. We expect a positive sign for this variable: countries with higher purchasing power of their consumers are expected to attract more foreign investors.

Besides the size and dynamics of the market and access to the host market, the prevailing factors for attracting FDI certainly include the cost and quality of input factors (Neuhaus, 2005). The analysis considers wages, as an independent variable, as a proxy variable for input cost. We calculate unit labor costs as the ratio of the annual average wage in each economy to GDP per capita in each economy. In this way, our measure of unit labor cost is effectively a unitless ratio (Bevan et al, 2004).

Successful implementation of economic reforms in transition countries is a good sign to potential investors, since stable macroeconomic performance implies a lower risk for investment. In this context, price stability is a good indicator for host governments' macroeconomic management. The sustainability of moderate or low inflation tells investors how successful the host government is and thus the prospect of further growth. Thus, the lower the average inflation rate is in the host country, the more foreign investment will be attracted to the country (Kinoshita and Campos, 2002). The paper therefore approximates macroeconomic stability with the inflation rate. We expect the higher inflation to have a negative effect on FDI inflows in the service sector, i.e. the coefficient to be negative.

Liberalization of trade could be closely related to FDI, because it could make the country more attractive for foreign investors. The paper used the shares of imports and exports in the observed countries' GDP as the degree of openness. The expected sign of the coefficient with this variable is positive.
Data used for independent variables are mainly those from the Vienna Institute for International Economic Studies (WIIW) Handbook of Statistics 2008. Despite the fact that there are different sources for independent variables, the goal was to use data only from a couple of sources in order to avoid problems due to different ways of defining variables and the way of data collection, at least in terms of independent variables..

The model we estimated to depict the determinants FDI is as follows:

$$FDIit == \alpha + \gamma i + \beta_1 GDPpc_{it} + \beta_2 OPENESS_{it} + \beta_3 WAGE_{it} + \beta_4 INFLATION_{it} + \beta_5 INSTITUTIONAL_{it} + e_{it}$$

where the prefix *L* indicates the log operator and:
$\alpha$ = the constant
$\gamma$ = country fixed effects
$GDPpc_{it}$ = per capita GDP of country i in year t
$OPENESS_{it}$= ratio of the trade of country i to its GDP in year t
$INFLATION_{it}$= consumer price index of country i in year t
INSTITUTIONAL = institutional related variables CP, BR, SM, T and OI
$\varepsilon_{it}$ = the error term.
Since the all variables are expressed in logs, the estimated coefficients should be interpreted as elasticities.

We used a panel data set covering eight CEE transition economies between 1997 and 2006. Data were not available for all the seven countries for all the years, and the dataset is therefore "unbalanced". Given the longitudinal nature of the dataset, we begin by estimating equation (1) with country fixed effects model (FEM)[4]. Use of pooled data in econometric analyses frequently leads to certain complications (Hicks 1994, 171-72). First, errors tend to be no independent from a period to the next. In other terms, they might be serially correlated, such that errors in country i at time t are correlated with errors in country i at time t+1. Second, the errors tend to be correlated across nations. They might be contemporaneously correlated, such that errors in country i at time t are correlated with errors in country j at time t. Third, errors tend to be heteroschesdastic, such that they may have differing variances across ranges or sub sets of nations. And fourth, errors may contain both temporal and cross-sectional components reflecting cross-sectional effects and temporal effects. In other words, even if we start with data that were homoschedastic and not auto-

[4] Results for FEM model is not presented due to space limitations

correlated, we risk producing a regression with observed heteroschestastic and auto-correlated errors. This is because heteroschedasticity and auto-correlation we observe is a function also of model misspecification. It is for this reason that we applied tests for checking the presence of heteroschedasticity and auto-correlation. First, a modified Wald test for groupwise heteroskedasticity in fixed effect regression model reveals the presence of heteroscedasticity which, while leaving coefficient estimates unbiased, can significantly influence standard errors and therefore affect hypothesis testing. There are a number of statistical techniques that can address this problem (e.g. weighted least squares), but their applicability and implementation are less clear in a panel context.
In addition to heteroscedasticity, the estimates using FEM model are also affected by serial correlation. In particular, a Wooldridge test for autocorrelation in panel data rejects the null hypothesis of no first order serial correlation. The consequences of autocorrelation are similar to heteroscedasticity, but the problems caused by the latter are usually more severe. OLS coefficient estimates remain consistent and unbiased in the presence of autocorrelation, but they are no longer best linear unbiased estimators (BLUE) or asymptotically efficient. Furthermore, autocorrelation causes standard errors to be biased.

Consequent to the previously described problems, both Parks-Kmenta method and Beck and Katz‘s (1995) proposal are alternatives. They represent two different approaches to tackle the complications of serial correlation, contemporaneous correlation and heteroscedasticity. Beck and Katz show that the overconfidence in the standard errors makes the Parks-Kmenta method unusable unless where there are more time points than there are cross-section units. In other words, they recommend using Parks only when T is very large relative to N, which is not the case in this paper (T is almost identical to N). Nevertheless, Beck and Katz (Beck and Katz, 1995) showed that these approaches significantly underestimate the variability of the estimated coefficients, especially if the sample size is small. In this study, we followed the suggestions of Beck and Katz and estimated OLS with panel-corrected standard errors (PCSEs) using Prais-Winsten to take into account the AR(1) process.

## Panel regression results

In Table 1 we report the results separately for each of the observed measures of institutional related variables combined with the same set of control variables.

**Table 1: Panel regression results**

| | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 |
|---|---|---|---|---|---|
| GDP_pc | 0,57** | 0,65*** | 1,03*** | 0,63* | 0,47 |
| | (0,26) | (0,22) | (0,28) | (0,35) | (0,33) |
| Openness | 0,19*** | 0,73** | 0,93** | 1,25*** | 0,72** |
| | (0,40) | (0,38) | (0,40) | (0,43) | (0,37) |
| Wage | 0,35 | 0,31 | 0,10 | 0,57* | 0,60** |
| | (0,25) | (0,21) | (0,31) | (0,33) | (0,29) |
| Inflation | -0,15*** | -0,14*** | -0,14*** | -0,13*** | -0,10** |
| | (0,05) | (0,05) | (0,05) | (0,05) | (0,04) |
| CP | 1,69*** | | | | |
| | (0,34) | | | | |
| BR | | 2,59*** | | | |
| | | (0,65) | | | |
| SM | | | 1,17** | | |
| | | | (0,50) | | |
| T | | | | 0,76*** | |
| | | | | (0,28) | |
| OI | | | | | 1,78*** |
| | | | | | (0,46) |
| R-sq[a] | 0,79 | 0,81 | 0,79 | 0,80 | 0,81 |
| Prob>chi2 | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 |
| N | 74 | 74 | 74 | 74 | 74 |

Source: Authors' calculations Note: Robust standard errors in parentheses. Asterisks indicate variables whose coefficients are significant at the 10%(*), 5%(**), and 1% (***) level, respectively. All regressions include a constant and country dummies (not reported in the table).
[a] There is no precise counterpart to $R^2$ in the generalised regression model. The $R^2$ from the transformed model is purely descriptive (see Greene 1999).

Turning first to the results for the control variables, we note that the variables display the correct sign. FDI is positively related to GDPpc and is always statistically significant except in model 5. Therefore, larger markets, which recorded faster economic growth, offered better opportunities for service industries to make use of their ownership advantages, which in turn led to a greater FDI inflow into this sector. Surprisingly, wages are insignificant although they have the expected sign in all the models. A possible explanation for the obtained results can be found in the use of average wages in the analysis, rather than the wages in the industry, since such data are not available for all the observed countries. Moreover, one of the possible explanations is that cheap but relatively skilled labor, although a favorable factor for investment, characterizes most of the transitions economies which compete with each other for foreign investment. Therefore it cannot be a specific advantage of any of these economies individually and cannot help attract foreign investors. Inflation manifests statistical significance at the level of 1-5% and has the negative algebraic sign as presumed. Macroeconomic instability, traditionally determined on the basis of the persistent rise of level of prices, increases the commercial risk of investment. High inflation weakens the confidence of foreign investors into the capability and readiness of the recipient country government to maintain a consistent monetary policy, stable prices and currency should their economies be exposed to turbulence of a greater scope. The fear of shock therapy which could cause losses inevitably affects the decision on possible investment in service industries. Openness is a variable always being highly significant and exerting a positive influence on the FDI in the service sector in SEE countries.

The analysis of significance and impact of the institutional-related variables on the FDI stock in services sector covered a series of the indicators of progress in the process of transition developed on the basis of EBRD methodology. All of five analyzed indicators in the model showed a considerable statistical significance (1%, and 5%) and, as expected, positively influenced FDI, thus empirically confirming the main initial hypothesis that establishing and strengthening institutions of market economy leads to the increase in FDI inflow into the service sector of the CEE countries.[5]

## CONCLUSION REMARKS

The purpose of this paper was to provide correlation between factors influencing on FDI level, based on literature mentioned in the paper, but in the service area. Since there are significant differences between the goods and services there is need to find out possible differences between the factors influencing FDI inflow in service area. The main goal of the research is to find out the factors which countries could use as the base for policies and strategies for promotion and attract of FDI in services.

We have found significant positive relation and influence of GDP and market openness to the level of FDI inflow in service sector, which is the relation confirmed in econometric analyses about total FDI inflow, as well as FDI inflow in manufacturing sector. Significant negative correlation have found between inflation rate level and FDI inflow, is expected too, since it implicated inadequate macroeconomic environment, as the one of critical variables likely to affect the location of FDI in the early years of the twenty and twenty first century. But, atypical relations, comparing to the FDI inflow in manufacturing sector, we found between the level of average wages and FDI inflow; the average level of salaries has had negative, but not significant factor for decision about the possible sector for investment. Possible explanation for this type of connection one can find in theories and motives for investment in services sector. None of motives in this type of investment is cheap labor, since services companies try to transnationalize ask for professional and skilled employees, and there is no way they are motivated with the level of salaries.

In the research we have found significant positive relation between tested variables: competition policy, banking reform and interest rate liberalization, securities markets & non-bank financial institution. That is means Hypothesis 1 and Hypothesis 2 confirmed completely and hypothesis 3 confirmed partially. Practically we rejected part of Hypothesis 3 regarding the level of average salaries as the motive for investment in service sector.

Those conclusions means, CEE countries wanting to promote and attract FDI in services should follow results and correlation between factors tested in research, but at the same time, insist on improvement of the areas, ranking with the lower level:

---

[5] Given that the eight countries of Central and Eastern Europe are highly convergent in terms of their level of economic performance as in terms of achieved structural reforms some of the analyzed institution-related variables BR and SM do not manifest sufficient variability (within standard deviations<0,05). The coefficients on variables with small within standard deviations may not be as well identified as the others. Given coefficients and standard errors for mentioned variables are high and that is consequence of the problem that was observed.

- Looking at the price liberalisation and competition policy, there is the patern of the activities CEE countries realize. There are preaty high rank in the price liberalisation area, which means they create relatively oppened markets for domestic and international supply, according neoliberal arguments for creating relatively or completely free market, without government influence. At the same time all countries have got below the average rank for the competition policy, imply there is negative perception about possibility to compete at the CEE countries markets. Possible reason for these results are the fact that some of the CEE countries try to protect domestic service area. Maybe specific example of this pattern is Slovenia, the country insisting to control level of FDI inflow in banking and financial sector. There are several other countries trying to keep at least part of services sector (public services, or financial services). Until all of them accept request for privatisation and deregulation all of those sectors, levels and ranks would be low. That means if CEE countries want to attract high level of FDI inflow in services they have to accept strong deregulation in service area. It is some kind of global interventionism in order to globalize and transnationalize those services area.

- Further implementation of banking reforms and liberalisation of financial services market. It is mportant for all countries from the region, except Checzech, Estonia and Hungary. They are ranked with 4 in 2005 and 2006 and very close to realize standards and performance norms of advanced industrial economies: full convergence of banking laws and regulation with BIS standards; provision of full set of competitive banking services.

- Development securities markets & non-bank financial institutions. This is the consequence of the fact that in most of researched countries, financial sector predominantly made of financial institutions, which implied they have to further develop other dimensions and subjects in this area, as well as creating security markets. The recommendation is practically for all the countries in the region, except in Hungary which evaluate with the 4 in the last year of the evaluation.
- Looking at the overall infrastructure reforms, ranking average indicators of reforms in electricity….are, researched countries have got the lowest indicators, looking at the average of investigated areas. Based on those information we can conclude CEE counutries have to continue the reforms, strengthen further legislative frameworks in order to ensure consistency with international standards and conventions, specifically in EU.

- Looking at the telecommunication sector, excluded from the infrastructural reforms, situation is much better. Most of the countries ranked between 4 and 4+, implicated complete commercialisation, including privatisation of dominant operator; comprehensive regulatory and institutional reforms, extensive liberalisation of entry or effective regulation through and independent entity, coherent regulatory and institutional framework to deal with tariffs, interconnection rules, licensing, concession fees and spectrum allocation, consumer ombdusmen function.

- Strengthen further legislative frameworks to ensure consistency with international standards and conventions. Ensure that policies in CEE countries are in line with the OECD Guidelines for Managing Conflict of Interest in the Public Sector and that appropriate resources are allocated for implementation. Strengthen public procurement institutions through regular training of public officials and monitoring of procurement cases. Implement and regularly monitor anticorruption policy, focusing on the evaluation of the effectiveness of policies in place and on the use of risk assessment techniques to idetify future priorities. Institutionalise regular, sustainable consultation mechanisms, with representatives of businesses for policy development, implementation and monitoring in all countries.

These results, which are confirmed by econometric studies and surveys on firms' investment intensions, are useful pointers to governments wishing to attract such investment. They are also suggest that these same governments need to pay constant attention to upgrading and reconfiguring their own unique, location-bound advantages (both actual and potential) and to targeting the kind of FDI that migt help them best accomplish this objective.

# REFERENCES


Banga Rashmi, Trade and Foreign Direct Investment in Services: A Review, Working Paper No. 154, *Indian Councile for Research on International Economic Relations*, February 2005, pp 22

Baum C.F. (2006). An *Introduction to Modern Econometrics Using Stata*, A Stata Press Publication, StataCorp LP, College Station, Texas

Beck, N & Katz J.N. (1995). What to Do (and Not toDo) with Time-Series-Cross-Section Data, *American Political Science Review* 89(3): 634–47.

Bevan et al. (2004). Foreign investment location and institutional development in transition economies, *International Business Review* 13 (2004) 43–64

Bevan, A. & Estrin, S. (2000). The determinants of foreign direct investment in transition economies, CEPR *Discussion Paper No. 2638*. London: Centre for Economic Policy Research

Bhagwati, Jagdish (1996) International Trade in Services and Its Relevance fr Economic Development, in Bhagwati-Jagdish, *Political economy and international economics*. Edited by Douglas A. Irwin. Cambridge and London: mIT Press, 1996; 235-69, Previously published. 1987

Bhagwati Jagdish (1991) Trade in Services and the mUltilateral Trade Negotiations", Bhagwati Jagdish, *Political economy and international economics*. Edited by Douglas A. Irwin. Cambridge and London: mIT Press, 1996; 282-306, Previously published. 1987

Blattner, T. (2002). Foreign Direct Investment in Transition, paper presented at the seminar on '*Europaische Kapitalmarkte im Wandel: Theorie und Empirie*', Free University Berlin, Department of Economics, Institute for Economic Policy and Economic History
Bhagwati Jagdish (1989), Is Free Trade Passe after Al?" *Weltwirtschaftliches-Archiv*; 125(1): 17-44

Buch, C.M. (2000), "Why do Banks Go Abroad? Evidence from German Data", *Financial Markets, Institutions and Instruments.*

Buckley, P.J. and Casson, M.C. (1976), "*The Future of the Multinational Enterprise*", Homes & Meier: London

Buigues, P. and Jacquemin, A. (1994). Foreign Direct Investment and Exports to the European Community, in M. Mason and D. Encarnation (eds.) Does Ownership Matter: *Japanese Multinationals in Europe*, Oxford and New York: Oxford University Press

Chanda Rupa (1997), Trade Liberalization and Foreign Direc Investment in Producer Services: A Theoretical and Empirical Study", *Working Paper, IIM Bangalore,* September 1997

Chanda Rupa (2000), "Impact of Trade Liberalization of Foreign Direct Investment in Producer Services", *working paper 103, IIM, Bangalore, September*.

Delali, A. (2003). The Determinants and Impacts of Foreign Direct Investment, *MPRA Paper No. 3084*, http://mpra.ub.uni-muenchen.de/3084/, (30/01/09)

Dunning, J. H. (1981), "Explaining the International Direct Investment Position of Countries: Towards a Dynamic or Developmental Approach", *Weltwirstchaftliches-Archiv. 117(1): 30-64*

Dunning, J.H. (1988). The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions, *Journal of International Business Studies*, vol.19, pp.1-31

Dunning, J.H.,, (1989), "Trade and Foreign-Oned Production in Services: Some Conceptual and Theoretical Issues", Giersch-Herbert, ed. *Services in world economic growth*: Symposium 1988. Tubingen, West Germany: Mohr (Siebeck); Boulder, Colo. and London: Wstview Press; 108-50.

Dunning, J.H. (2005). Towards a New Paradigm of Development; Implications for the Determinants of *International Business Activity, Mimeo*, Universities of Reading and Rutgers.

Dunning, J.H. & Buckley. P.J. (1977). International Production and Alternative Models of Trade, *Manchester School of Economic and Social Studies*, vol.45, pp.393-403

Fukao Kyojy and Keiko Ito (2000), Foreign Direct Invesment and Service Trade: The Case of Japan, *Hitotsubashi University, mimeo*.

Gray, J.M and Gray, H. (1981) The multinational bank: A financial multinational corporation?", *Journal of Banking and Finance* 5(1), 33-63

Gronroos, Ch. (2007), " Service Management and Marketing" 3rd ed., John Wiley & Sons, Ltd

Helpman, E. (1984), "A Simple Theory of International Trade with Multinational Corporations", *Journal of Political Economy*, June 92(3), 451-71.

Hill P. (1997), "On Goods and Services", *The Review of Income and Wealth*, Vol. 23. No. 4.

Holland, D. & Pain, N. (1998). The diffusion of innovations in Central and Eastern Europe: A study of the determinants and impact of foreign direct investment, NIESR Discussion Paper No. 137, *London: National Institute of Social and Economic Research.*

Hymer, S. (1976), International operations of national firms: A study of direct investment. *Cambridge, Mass: MIT Press*.

Kinoshita,Y. & Campos N. (2003). Why Does FDI Go Where it Goes ? New Evidence from the Transition Economies, *Williamson Institute Working paper*, 573.

Lankes, H. P. & Venables, A. J. (1996). FDI in economic transition: the changing pattern of investments. *Economics of Transition*, 4(2), 331-347.

Lansbury, M., Pain, N., & Smidkova, K. (1996). Foreign direct investment in Central Europe since 1990: An econometric study. *National Institute Economic Review*, 156, 104–124.

Markusen,, J.R. et al (1996), "A Unified Tretament of Horizontal Direct Investment, Vertical Direct Investment and the Pattern of Trade in Goods and Servicces", *National Buerau of Economic Research, In. NBER Working Papers: 5696*

Miller, S.R. and Parkhe, A. (1998), "Patterns in the expansion of U.S. banka' foreign operations", *Journal of international business studies*, 29, 2, 359-390

Moshirian, F. (1997), "Foreign direct investment in insurance services in the United States", *Journal of multinational financial management*, 7, 159-173

Mudambi, R., Navarra, P. (2002): Institutions and International Business: a theoretical overview, *International Business Review*, 11(6): 635-646.

Neuhaus, M. (2005). The Impact of FDI on Economic Growth, An Analysis for the Transition Countries of Central and Eastern Europe', *Physica-Verlag, A Springer Company*

Podesta, F. (2000). Recent developments in quantitative comparative methodology: the case of pooled time series cross-section analysis, *DSS PAPERS SOC 3-02*

Pournarakis, M. & Varsakelis, N. (2004). Institutions, internationalization and FDI: the case of economies in transition, *Transnational Corporations*, vol. 13 (2), August 2004, pp. 77-94.

Quere, A. B. et al. (2005). Institutional Determinants of Foreign Direct Investment, CEPII, *Working Paper No 2005-05.*

Raff, H. and M. von der Ruhr (2001), Foreign Direct Investment in Producer Services: Theory and Empirical Evidence", *Mimeo, University of Kiel.*

Resmini, L. (2000). The determinants of foreign direct investment in the CEECs: New evidence from sectoral patterns, *Economics of Transition*, 8(3), 665-689.

Schroath, F.W. Korth, Ch.M. (1989) Managerial Barriers to the Internationalization of U.S. Proper5ty and Liability Insurers: Theory and Perspectives" *Journal of Risk and Insurance*, December 56 (4): 630-48

Sauvant, K.P. (1990), "The Tradability of Services", Messerlin-Patric-A.; Sauvant, K.P. eds. The Uruguay Round: *Services in the world ecnonomy. With contributionns by bela Balassa et al Washington, D.C.: World Bnk; New York: United Nations Centre on Transnational Corporations*, 114-22.

Vernon, R. (1966), "International investment and international trade in the product cycle", *Quarterly Journal of Economics, May, 80 (2), p. 190-207.*

WorldBank. (1996). World development report. Washington, DC: Oxford University Press.

Yamori, N. (1998), "A note on the location choice of multinational banks: The case of Japanese financial institutions", *Journal of banking and finance, 22, 109-120*

# THE RELATIONSHIP BETWEEN SUBSIDIARY SIZE AND SUBSIDIARY AUTONOMY IN TURKISH OUTWARD FOREIGN DIRECT INVESTMENTS

**İbrahim Anıl, Marmara University**

**Binali Doğan, Marmara University**

## ABSTRACT

*The present study investigated the relationship between subsidiary size and subsidiary autonomy amongst Turkish companies investing directly in Central Asia, Russia and Balkan Countries (Anıl et al., 2007). An extensive literature exists on the size-autonomy relationship amongst subsidiary companies in developed economies (Johnston and Mengüç, 2007; Hedlund, 1981; Paterson and Brock, 2002; Grover and Davenpont, 2001). The findings of the present study indicate that autonomy levels amongst subsidiaries of Turkish companies involved in outward direct investment are very similar to those of subsidiaries from developed countries. When explanatory factor analysis is applied to the thirteen autonomy criteria, the results are distributed under 3 factors. Each factor has a different level of autonomy.*

*This study investigated factors in the relationship between subsidiary size and subsidiary autonomy. Factors such as international experience, brand and product image, use of technology and managerial information, experience in markets of the chosen country, quality of professional development program, staff quality and product differentiation and development skills were measured as the starting advantages (Ownership) of the firms (Hymer, 1976; Dunning, 2000, 1977, 1993; Comison-zomoza, 2004). The findings indicate that experience in the target market significantly affected the autonomy levels of subsidiary companies.*

*Among the investment motives of Turkish firms, it is possible to find two of the three motives that Dunning used in his "Eclectic" approach: investing to seek markets and; to seek resources. (Dunning, 1977, 1993) The two groupings have been used in the present study, since the companies in this region do not have the opportunity to engage in international growth (Makino et al., 2002), and so seek strategic resources and opportunities to innovate. The results indicate that autonomy is greater amongst resource-seeking subsidiaries than market-seeking subsidiaries.*

*The results are discussed with reference to resource-based theories.(Hoskisson et al., 2000; Negandhi and Baliga, 1981; Cool and Henderson, 1998)*

**Keywords:** *Autonomy, subsidiary size, Ownership advantages.*

## INTRODUCTION

Following the dissolution of the Soviet Union, Turkish companies have sought opportunities for direct investment in the new republics. Direct investments by Turkish companies and individual entrepreneurs take place within two forms of corporate structure: Independent companies, and; subsidiary companies, managed centrally by a parent company. The present study comprised 42 companies with interests in 7 different countries (Bulgaria, Romania, Uzbekistan, Kazakhstan, Turkmenistan, Kyrgyzstan and Russia). The study was conducted with the support of the Scientific Researches Commission of Marmara University, Turkey.

The focus of the present research is the relationship between business autonomy and growth. The link between autonomy and growth was tested through the quadratic model developed by Hedlund (1981), and which was subsequently validated by the work of several researchers (Johnston and Mengüç, 2007; Paterson and Brock, 2002; Grover and Davenpont, 2001).

The level of company autonomy was tested by comparing the relative influence of the subsidiary or parent company in 13 fields. Growth was defined by the number of workers (Johnston and Mengüç, 2007).

# LITERATURE REVIEW

Autonomy, as a variable of organizational structure, has been the focus of many previous studies within the business administration literature. The determinants of the organizational structure, foremost of which are those of Aston Group and Woodward, form an important axis of administration studies. Decisions regarding centralization or autonomy are tools utilized by companies in order to solve problems or to evoke their sources to achieve their goals in the most effective way. When the goals are in question it is intended to maximize profitability and reduce commercial risks (Garnier, 1982). Business activities conducted overseas involve greater risk, because they are conducted in a different political and commercial environment than those of the home country. Effective management is therefore more difficult than that of the activities of the main firm. Although the main firm may wish to retain control of all decisions, commercial risk perception and the importance of the opportunities which might be utilized by the subsidiary company come to determine the subsidiary company's level of autonomy.

The autonomy levels of subsidiary companies have been a focus of study within the field of international management since 1980. Previous researchers have attempted to define the determinants of subsidiary autonomy levels, and there is an extensive body of literature in this field. Garnier suggested that risk perception is a significant determinant in the autonomy of corporate subsidiaries and determined the relationship between the central and subsidiary company based on three distinct elements (Garnier, 1982). Previous studies have consistently found that the growth of the subsidiary company is an important factor in establishing its level of autonomy (Negandhi and Baligna, 1981; Welge, 1981, 1994). Some studies found that the growth and conditions of the home country of the parent company were determinants in subsidiary autonomy (Hedlund, 1981). Birkinshaw and Hood (1998) claimed that growth is just one of the determinants of autonomy. Previous researchers have also studied the competency strategies of subsidiary companies (Bartlett and Ghoshal, 1986) as well as the growth of resources administered and controlled by it (Hedlund, 1981) and the ways in which initial advantages affect autonomy (Birkinshaw *et al*., 1998). Due to the fact that business expansion requires the complex coordination of processes and greater expert knowledge and experience, this can necessitate a return to dependence on the parent company (Johnston and Mengüç, 2007).

The autonomy level of the subsidiary company varies depending on the criteria by which it is measured. Comparison is problematic because the results of the 13 criteria are utilized in this research. Other research have 3, 7, 9 criteria, therefore they contain differences despite the similarities. Decisions regarding capital expenditure, appointment and evaluation of top level executives as well as the development of quality standards and the selection of suppliers do not have the same importance.

In the present study, autonomy was measured based on all types of decisions within all areas of the business, and autonomy levels were individually graded with regard to strategically, functional and operational fields.

# METHOD AND FINDINGS

## Method

The modeling framework of the research consisted of the direct investment of Turkish companies in seven foreign countries. In this context, the sampling of the research was designed in the seven countries with which the direct investments from Turkey are realized through the Associations of the Businessman and the Commerce Office of Attaché. The sectors represented in the study were the result of a random sample.

Data was collected via a questionnaire form with 13 questions, designed to measure the level of dependence degree on the parent company. The questionnaire structure was based that used by Glaister ve Tatoğlu (1998). In this study, data from 42 firms that directly invest in the seven Turkic Republics were collected through surveys and in-depth interviews with the top executives visited in 2004 and 2006. The population of this study has determined by Turkish Businessman Associations and Turkish trade attaches of each country. Every firm which has more than 50 employees was visited in that period like 42 firms involved in this study.

The 13 interview questions designed to measuring the level of dependence on the parent company are shown below. A 5-point Likert scale was utilized, where the lowest level is indicated by 1 and the highest one is indicated by 5.

a) Capital expenditures, CAPEX
b) Product development, PRODEV
c) Strategy formulation, STRFOR
d) Pricing strategy, PRISTR
e) Marketing and sales, MNGSALE
f) Quality standards, QUASTN
g) Choice of suppliers, CHOSUPP
h) Budgeting process, BUDPRC
i) Dividend policy, DIVPOL
j) Wage and labor policy, WAGEPOL
k) Training and development policy, TRAIPOL
l) Selection, promotion and compensation of executives, SPCEXC
m) Administration and supervision, ADMSUP.

The organizational growth variable was measured through the number of subsidiary workers. Although this variable was often utilized at the scale during the initial phases of the research, it was replaced with the categorical variable in the later phases. In this transformation, 1 was used for companies with a maximum of 200 employees; 2 for companies with between 200 and 400 employees, and; 3 for companies with over 400 employees.

# FINDINGS

## Findings of Autonomy and Size Relations

Each participating company was asked about their dependence upon the parent company. Table 1 shows descriptive statistics that based on the responses.

***TABLE I. Descriptive Statistics***

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| CAPEX | 42 | 1,0 | 5,0 | 4,143 | 1,4579 |
| PRODEV | 42 | 1,0 | 5,0 | 2,405 | 1,6537 |
| STRFOR | 42 | 1,0 | 5,0 | 3,000 | 1,2688 |
| PRİSTR | 42 | 1,0 | 5,0 | 2,000 | 1,4142 |
| MNGSALE | 42 | 1,0 | 5,0 | 1,833 | 1,2863 |
| QUASTN | 42 | 1,0 | 5,0 | 2,476 | 1,7424 |
| CHOSUPP | 42 | 1,0 | 5,0 | 2,417 | 1,5847 |
| BUDPRC | 42 | 1,0 | 5,0 | 2,714 | 1,1537 |
| DİVPOL | 42 | 3,0 | 5,0 | 4,881 | ,4528 |
| WAGEPOL | 42 | 1,0 | 5,0 | 1,857 | 1,2212 |
| TRAİPOL | 42 | 1,0 | 5,0 | 1,786 | 1,2979 |
| SPCEXC | 42 | 1,0 | 5,0 | 3,833 | 1,5447 |
| ADMSUP | 42 | 1,0 | 5,0 | 4,524 | 1,0415 |
| Valid N (listwise) | 42 | | | | |

The autonomy level of each company was determined by establishing their dependence on the parent company. Since there is an inversely proportional relationship between dependence on the center and autonomy, it is possible to calculate the autonomy level based on the level of dependence on the center.

Factor analysis was carried out to establish in how many dimensions the dependence level on the center was measured immediately after having been practiced the questionnaire form following the phase of the cleaning and preparation of the data. The results indicated that 3 different factors had contributed to the measured dependence on the parent company. Table 2 shows the results of the factor analysis, the definitions of each of the factors and the variables contained within it.

Factor 1 refers to the functional dimension and comprises 7 variables. These are: marketing and sales (MNGSALE), pricing strategy (PRISTR), strategy formulation (STRFOR), product development (PRODEV), training and development policy (TRAIPOL), wage and labor policy (WAGEPOL), and budgeting process (BUDPRC).
Factor 2 refers to the strategically dimension and comprises 4 variables. These are: selection, promotion and compensation of executives (SPCEXC), dividend policy (DIVPOL), capital expenditure (CAPEX), and administration and supervision (ADMSUP).

Factor 3 refers to the operational dimension and comprises 2 variables. These are: quality standards (QUASTN), and choice of suppliers (CHOSUPP).

**TABLE II. Rotated Component Matrix**

| | Component | | |
|---|---|---|---|
| | 1 | 2 | 3 |
| MNGSALE | ,880 | | |
| PRİSTR | ,853 | | |
| STRFOR | ,833 | ,346 | |
| PRODEV | ,783 | | ,288 |
| TRAİPOL | ,722 | | ,336 |
| WAGEPOL | ,684 | | ,467 |
| BUDPRC | ,637 | ,319 | ,446 |
| SPCEXC | | ,833 | ,326 |
| DİVPOL | | ,719 | -,345 |
| CAPEX | | ,672 | ,448 |
| ADMSUP | | ,600 | |
| QUASTN | ,327 | | ,788 |
| CHOSUPP | ,468 | | ,668 |

Since the factors to be acquired point out to the dimensions of the dependence level on the center, lower values are indicative of greater autonomy within the subsidiary company.

Following factor analysis, the internal validity of the questionnaire was tested via Cronbach's Alpha scores. Factor 1 had a very high Cronbach’s Alpha value of 0.93; Factor 2 had a lower but satisfactory Cronbach’s Alpha value of 0.696, and; Factor 3 had a high Cronbach’s Alpha value of by 0.75.

In the first analysis no statistically significant relationship was found between the growth of the subsidiary company and the level of autonomy. The regression models acceding that the growth of the company is independent and each factor is significant were not able to produce significant results at neither the linear nor the quadratic level. Therefore, it was concluded that the growth of the company cannot explain the variables which constitute up the various dimensions of subsidiary autonomy.

In this phase, it was decided to explain the variable of company growth at the categorical scale by eliminating the problems of the data quality. Table 3 shows the distribution of the frequency acquired as a result of the explanation of the companies through 3 distinct categories.

Analysis of variance (ANOVA) was conducted to test whether there was a significant difference between the subsidiary companies in the different categories of the growth regarding the autonomy levels. The research hypotheses tested were:

$H_1$ 1: There is difference among the subsidiary companies concerning the growth.

**TABLE III. Frequency distribution of companies according to the growth**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | 1,00 | 18 | 42,9 | 42,9 | 42,9 |
| | 2,00 | 10 | 23,8 | 23,8 | 66,7 |
| | 3,00 | 14 | 33,3 | 33,3 | 100,0 |
| | Total | 42 | 100,0 | 100,0 | |

Hypothesis testing at 3 different factor levels indicated that there were statistically significant differences between the groups. Table IV shows the results of the analysis of variance concerning 3 factors. The results indicate that the significance level for factor 1 is 0.000; the significance of factor 2 is 0.012; that the significance of factor 3 is 0.008.

**TABLE IV. ANOVA Tables**

| | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| F1 | Between Groups | 17,481 | 2 | 8,741 | 9,969 | ,000 |
| | Within Groups | 34,194 | 39 | ,877 | | |
| | Total | 51,676 | 41 | | | |
| F2 | Between Groups | 6,317 | 2 | 3,159 | 4,967 | ,012 |
| | Within Groups | 24,802 | 39 | ,636 | | |
| | Total | 31,119 | 41 | | | |
| F3 | Between Groups | 20,063 | 2 | 10,032 | 5,520 | ,008 |
| | Within Groups | 70,879 | 39 | 1,817 | | |
| | Total | 90,942 | 41 | | | |

Scheffe statistics was utilized to identify among which groups the significant differences occur. The results are shown in Table V.

The results indicate a significant difference between the first and the third group at each factor level. In other words, the autonomy levels of the small and large scale enterprises differ. The average differences where the significant differences occur show that these differences would stem from the decreasing of the autonomy as long as the company growth of them increase. Hence, there is greater autonomy within small-scale enterprises than within larger ones

**TABLE V. Multiple Comparisons**

| Dependent Variable | (I) buyukluk olcek | (J) buyukluk olcek | Mean Difference (I-J) | Std. Error | Sig. | 95% Confidence Interval | |
|---|---|---|---|---|---|---|---|
| F1 | 1,00 | 2,00 | -,67143 | ,36931 | ,205 | -1,6113 | ,2684 |
| | | 3,00 | -1,48980(*) | ,33367 | ,000 | -2,3389 | -,6407 |
| | 2,00 | 1,00 | ,67143 | ,36931 | ,205 | -,2684 | 1,6113 |
| | | 3,00 | -,81837 | ,38769 | ,121 | -1,8050 | ,1682 |
| | 3,00 | 1,00 | 1,48980(*) | ,33367 | ,000 | ,6407 | 2,3389 |
| | | 2,00 | ,81837 | ,38769 | ,121 | -,1682 | 1,8050 |
| F2 | 1,00 | 2,00 | -,43056 | ,31452 | ,400 | -1,2310 | ,3698 |
| | | 3,00 | -,89484(*) | ,28417 | ,012 | -1,6180 | -,1717 |
| | 2,00 | 1,00 | ,43056 | ,31452 | ,400 | -,3698 | 1,2310 |
| | | 3,00 | -,46429 | ,33018 | ,381 | -1,3045 | ,3760 |
| | 3,00 | 1,00 | ,89484(*) | ,28417 | ,012 | ,1717 | 1,6180 |
| | | 2,00 | ,46429 | ,33018 | ,381 | -,3760 | 1,3045 |
| F3 | 1,00 | 2,00 | -,28889 | ,53170 | ,863 | -1,6420 | 1,0642 |
| | | 3,00 | -1,54960(*) | ,48040 | ,010 | -2,7721 | -,3271 |
| | 2,00 | 1,00 | ,28889 | ,53170 | ,863 | -1,0642 | 1,6420 |
| | | 3,00 | -1,26071 | ,55817 | ,091 | -2,6812 | ,1597 |
| | 3,00 | 1,00 | 1,54960(*) | ,48040 | ,010 | ,3271 | 2,7721 |
| | | 2,00 | 1,26071 | ,55817 | ,091 | -,1597 | 2,6812 |

In the event that 5 different groups are formed by practicing another method in the classification of the companies' growth, the finding in question doesn't alter. The relative frequency of each group would be approximately 0, 20 in the phase of forming 5 different groups according to the company growths from small to large scale.

Table VI presents the frequency distribution of the subsidiary companies across 5 different categories, according to their levels of growth. Analysis of variance was performed to establish whether there was a difference between the growths of the companies in terms of autonomy levels (see Table VII).

**TABLE VI. Frequency Distribution of Growth of Subsidiary Companies**

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | 1,00 | 8 | 19,0 | 19,0 | 19,0 |
| | 2,00 | 10 | 23,8 | 23,8 | 42,9 |
| | 3,00 | 10 | 23,8 | 23,8 | 66,7 |
| | 4,00 | 8 | 19,0 | 19,0 | 85,7 |
| | 5,00 | 6 | 14,3 | 14,3 | 100,0 |
| | Total | 42 | 100,0 | 100,0 | |

The table shows a significant difference at the level of 0. 05 for the factor 1 and 3 and at the level of only 0, 10 for the factor 2 in terms of autonomy levels among the growths of the subsidiary companies. The significance levels were respectively 0.000 for factor 1; 0.058 for factor 2, and; 0.002 for factor 3.

**TABLE VII. ANOVA Tables**

| | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| F1 | Between Groups | 21,702 | 4 | 5,426 | 6,698 | ,000 |
| | Within Groups | 29,973 | 37 | ,810 | | |
| | Total | 51,676 | 41 | | | |
| F2 | Between Groups | 6,652 | 4 | 1,663 | 2,515 | ,058 |
| | Within Groups | 24,467 | 37 | ,661 | | |
| | Total | 31,119 | 41 | | | |
| F3 | Between Groups | 33,556 | 4 | 8,389 | 5,409 | ,002 |
| | Within Groups | 57,386 | 37 | 1,551 | | |
| | Total | 90,942 | 41 | | | |

Scheffe statistics were utilized to find among which groups the difference was significant. According to the test result it is the fourth group producing significant difference in the sense of factor 1. The fourth group is significantly different from both the first and the second groups. Autonomy is high within small scale enterprises and shows an alteration similar to the linear decreasing in parallel with the enlargement and raising again at the biggest scale.

The fourth group shows significant difference in terms of decisions related to the formation of quality standards and selection of suppliers (factor 3). The second and third groups also show significant differences. The alteration dependent on growth is similar to factor 1. Similar results were reported by Hedlund (1981) and Johnson and Mengüç (2007).

It was stated previously that no significant difference had been found for factor 2 at the 0.05 confidence level. Factor 2 includes strategic and fundamental decisions, and constitutes the decision fields which are rarely delegated to subsidiaries by the parent company. Decisions on Capital expenditure, distribution of profits, the appointment and evaluation of top level executives, as well as the hand-over to the subsidiary company of administration and supervision roles are difficult decisions to turn over to the subsidiary. The graphics representation of Factor 2 below shows how much higher the dependence on the center is for this factor than the other factors.

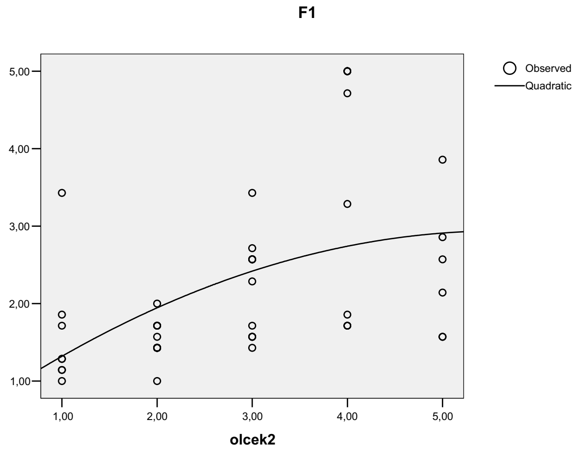
*TABLE VIII. Multiple Comparisons*

| Dependent Variable | (I) olcek2 | (J) olcek2 | Mean Difference (I-J) | Std. Error | Sig. | 95% Confidence Interval | |
|---|---|---|---|---|---|---|---|
| F1 | 1,00 | 2,00 | ,06429 | ,42693 | 1,000 | -1,3194 | 1,4480 |
| | | 3,00 | -,63571 | ,42693 | ,697 | -2,0194 | ,7480 |
| | | 4,00 | -1,92857(*) | ,45003 | ,004 | -3,3871 | -,4700 |
| | | 5,00 | -,82143 | ,48608 | ,588 | -2,3968 | ,7540 |
| | 2,00 | 1,00 | -,06429 | ,42693 | 1,000 | -1,4480 | 1,3194 |
| | | 3,00 | -,70000 | ,40252 | ,560 | -2,0046 | ,6046 |
| | | 4,00 | -1,99286(*) | ,42693 | ,001 | -3,3766 | -,6092 |
| | | 5,00 | -,88571 | ,46478 | ,469 | -2,3921 | ,6207 |
| | 3,00 | 1,00 | ,63571 | ,42693 | ,697 | -,7480 | 2,0194 |
| | | 2,00 | ,70000 | ,40252 | ,560 | -,6046 | 2,0046 |
| | | 4,00 | -1,29286 | ,42693 | ,078 | -2,6766 | ,0908 |
| | | 5,00 | -,18571 | ,46478 | ,997 | -1,6921 | 1,3207 |
| | 4,00 | 1,00 | 1,92857(*) | ,45003 | ,004 | ,4700 | 3,3871 |
| | | 2,00 | 1,99286(*) | ,42693 | ,001 | ,6092 | 3,3766 |
| | | 3,00 | 1,29286 | ,42693 | ,078 | -,0908 | 2,6766 |
| | | 5,00 | 1,10714 | ,48608 | ,289 | -,4683 | 2,6825 |
| | 5,00 | 1,00 | ,82143 | ,48608 | ,588 | -,7540 | 2,3968 |
| | | 2,00 | ,88571 | ,46478 | ,469 | -,6207 | 2,3921 |
| | | 3,00 | ,18571 | ,46478 | ,997 | -1,3207 | 1,6921 |
| | | 4,00 | -1,10714 | ,48608 | ,289 | -2,6825 | ,4683 |
| F3 | 1,00 | 2,00 | 1,03750 | ,59074 | ,551 | -,8771 | 2,9521 |
| | | 3,00 | ,28750 | ,59074 | ,993 | -1,6271 | 2,2021 |
| | | 4,00 | -1,65625 | ,62269 | ,156 | -3,6744 | ,3619 |
| | | 5,00 | -,06250 | ,67258 | 1,000 | -2,2424 | 2,1174 |
| | 2,00 | 1,00 | -1,03750 | ,59074 | ,551 | -2,9521 | ,8771 |
| | | 3,00 | -,75000 | ,55695 | ,769 | -2,5551 | 1,0551 |
| | | 4,00 | -2,69375(*) | ,59074 | ,002 | -4,6083 | -,7792 |
| | | 5,00 | -1,10000 | ,64311 | ,576 | -3,1843 | ,9843 |
| | 3,00 | 1,00 | -,28750 | ,59074 | ,993 | -2,2021 | 1,6271 |
| | | 2,00 | ,75000 | ,55695 | ,769 | -1,0551 | 2,5551 |
| | | 4,00 | -1,94375(*) | ,59074 | ,045 | -3,8583 | -,0292 |
| | | 5,00 | -,35000 | ,64311 | ,990 | -2,4343 | 1,7343 |
| | 4,00 | 1,00 | 1,65625 | ,62269 | ,156 | -,3619 | 3,6744 |
| | | 2,00 | 2,69375(*) | ,59074 | ,002 | ,7792 | 4,6083 |
| | | 3,00 | 1,94375(*) | ,59074 | ,045 | ,0292 | 3,8583 |
| | | 5,00 | 1,59375 | ,67258 | ,252 | -,5861 | 3,7736 |
| | 5,00 | 1,00 | ,06250 | ,67258 | 1,000 | -2,1174 | 2,2424 |
| | | 2,00 | 1,10000 | ,64311 | ,576 | -,9843 | 3,1843 |
| | | 3,00 | ,35000 | ,64311 | ,990 | -1,7343 | 2,4343 |
| | | 4,00 | -1,59375 | ,67258 | ,252 | -3,7736 | ,5861 |

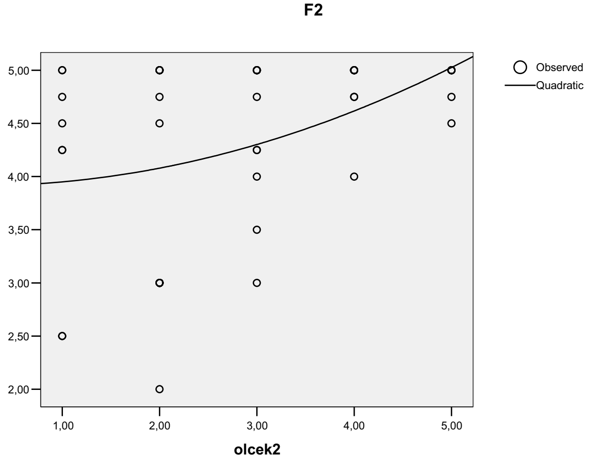
Table VIII above shows the bipartite average comparisons for factors 1 and 3, in which statistically significant differences were identified.

That there hadn't occurred a significant difference between the first group and the fifth group draws attention in that point. It should be noted that there was no significant difference identified between the first group and the fifth group. It means the autonomy levels of the smallest and the largest scale companies has same.

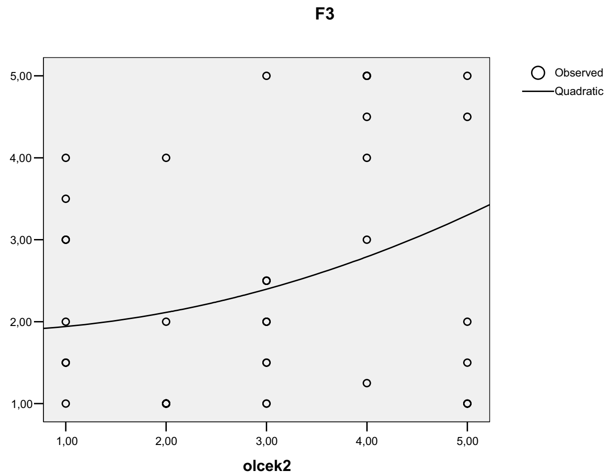
**GRAPHIC 1. Quadratic Trend in Factor I in terms of Growth**




**GRAPHIC II. Quadratic Trend in the Factor II in terms of Growth**



**GRAPHIC III. Quadratic Trend in Factor III in terms of Growth**




The same point is seen as a result of the trend section of 5 groups for the average dependency values. Graphic 1 shows the alteration in the factor 1, graphic points to that of the factor 2 with the same approach and graphic 3 demonstrates that of the factor 2 and 3 as the most appropriate curvilinear trend for the distribution of the data. This appearance testifies that the dependence level of the smallest and the largest scale enterprises are similar.

It is necessary to evaluate the relationships presented in the 3 graphics in terms of compatibility and significance. The R-square values (0.245; 0.172 and 0.094), indicating the fit of the curve with the data are relatively poor. The significance levels are 0.004; 0.025 and 0.147 respectively. In that case, the relationships observed for factors 1 and 2 are weak but statistically significant; those of factor 3 are both weak and statistically insignificant.

## The Relation of the Destination Aim with the Level of the Dependence

Among the investment motives of Turkish firms, it is possible to find two of the three motives that Dunning used in his "*Eclectic*" approach: investing to seek markets and; to seek resources. (Dunning, 1977, 1993) The two groupings have been used in the present study.

Differences were observed as a result of the classification performed due to the variable of "the effect of the market growth of the country, as a market seeking motives in the investment decision" that oriented to the principle of establishment of the subsidiary company. Similarly, the level of dependence differentiated in the classification conducted on account of the variable of the effect of "the facility of the access to the neighboring markets as a resource seeking motives in the investment decision. An independent sampling T test was utilized to test for significant differences, since the subsidiary companies classified in this two groups for both two of the variables. The results in question are presented with Table IX and Table X.

**TABLE IX. T Test for the Importance of Market Growth**

| | | t-test for Equality of Means | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | t | df | Sig. (2-tailed) | Mean Difference | Std. Error Difference | 95% Confidence Interval of the Difference | |
| | | | | | | | Lower | Upper |
| F1 | Equal variances not assumed | -2,925 | 34,854 | ,006 | -,80569 | ,27548 | -1,36503 | -,24636 |
| F2 | Equal variances assumed | -,312 | 35 | ,757 | -,10315 | ,33030 | -,77369 | ,56740 |
| F3 | Equal variances not assumed | -1,599 | 28,156 | ,121 | -,70455 | ,44050 | -1,60665 | ,19756 |

A statistically significant difference was found at the 0.05 confidence level for factor 1, in terms of dependence, between the companies targeting market growth of the destination country and the others. The significance level was 0.006.

No statistically significant difference was found at the 0.05 confidence level for factor 2, in terms of dependence, between the companies targeting the market growth of the destination country and the others. The significance level was 0.757.

No statistically significant difference was found at the 0.05 confidence level for factor 3, in terms of dependence, between the companies targeting the market growth of the destination country and the others. The significance level was 0.121.

*TABLE X. T Test for the Importance of the Resources of the Destination Countries*

| | | t-test for Equality of Means | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | t | df | Sig. (2-tailed) | Mean Difference | Std. Error Difference | 95% Confidence Interval of the Difference | |
| | | | | | | | Lower | Upper |
| F1 | Equal variances assumed | -,169 | 37 | ,867 | -,06449 | ,38182 | -,83814 | ,70916 |
| F2 | Equal variances not assumed | 2,324 | 31,545 | ,027 | ,53071 | ,22839 | ,06523 | ,99620 |
| F3 | Equal variances assumed | ,173 | 37 | ,864 | ,08643 | ,50006 | -,92679 | 1,09964 |

No statistically significant difference was found at the 0.05 confidence level for the factor 1, in terms of dependence, between the companies targeting the resources of the destination country and the others. The significance level was 0.867.

There was a statistically significant difference at the 0.05 confidence level for factor 2, in terms of dependence, between the companies targeting the resources of the destination country and the others. The significance level was 0.027.

No statistically significant difference was found at the 0.05 confidence level for factor 3, in terms of dependence, between the companies targeting the resources of the destination country and the others. The significance level was 0.864.

## Relationship between Ownership Advantage and Autonomy

It is seen that the experienced firm groups' average value of the independence on the center in the destination country is higher than that of the relatively inexperienced firm groups. A T test of independent samples was conducted to establish whether this difference was statistically significant at the 0.05 confidence level.

Factor 1 shows differences in terms of experience in the destination country. The significance level of the occurring difference was 0.027 between the company groups that were experienced and those that were inexperienced. Factor 2 shows differences in terms of experience in the destination country. The significance level for factor 2 was 0.008 between the company groups that were experienced in the destination country and those that were inexperienced.

Factor 3 shows differences in terms of experience in the destination country. The significance level for factor 3 was 0.031 between the company groups that were experienced in the destination country and those that were inexperienced.

**TABLE XI. T Test for Experience in terms of the Destination Country**

| | | t-test for Equality of Means | | | | |
|---|---|---|---|---|---|---|
| | | t | df | Sig. (2-tailed) | Mean Difference | Std. Error Difference |
| F1 | Equal variances not assumed | -2,305 | 36,574 | ,027 | -,73194 | ,31756 |
| F2 | Equal variances not assumed | -2,833 | 31,465 | ,008 | -,72654 | ,25643 |
| F3 | Equal variances assumed | -2,231 | 40 | ,031 | -,98341 | ,44083 |

No significant difference was observed in terms of the other starting advantages of the ownership.

# CONCLUSIONS

The relationship between autonomy levels and growth of Turkish companies is differentiated by their decision fields. In the field of strategic decisions, it was established that all the decisions within that field remain within the control of the center when the scale augments very much and the center is highly effective independently of the growth, for all decision area. Decisions concerning the designation of quality standards and selection of suppliers are taken by the higher autonomy for subsidiaries and the lower autonomy for center within small scale subsidiary companies. The control of the center increases in parallel with the augmentation of the scale and decreases the autonomy of the subsidiary company. The autonomy of subsidiaries declines with increasing organizational scale; within larger-scale organizations, the parent company retains a greater level of central control, thereby reducing the autonomy of the subsidiary. Decisions concerning the determination of politics belonging to the functional field, the control of the higher autonomy are in question in the small scale subsidiary companies and the control of the center is lowest for large scale organizations. In terms of factors 1 and 2, when the five growth categories are examined, the findings indicate that there is no difference in levels of autonomy between the smallest to the largest scale companies proves that a compatible consequence with the quadratic modeling has arrived.
In cases where there is an experienced center, parent organization in the chosen country's markets, in terms of the relation between scale and autonomy, it was demonstrated that the control of the center is higher while that of the subsidiary is lower.

It was shown that the autonomy level of subsidiaries, whose firms take market growth as basis for the selection of countries, is higher in the area of functional decisions. A significant difference was found in terms of the fundamental decisions concerning the autonomy of subsidiaries of firms seeking resources within the chosen country, with greater decision-making retained at the center.

## REFERENCES


Anıl İ, Armutlulu İ, Sungur N, Bakoğlu R, Aşkun B.(2007), Türkiye'den Gelişmekte Olan Ülkelere Yapılan Doğrudan Sermaye Yatırımları, Marmara Üniversitesi, Bilimsel Araştırmalar Komisyonu Yayını, İstanbul

Comison-zomoza C, Lapiedra-Alcami, R., Segarra-Cipres, M., Boronat-Naverra, M., (2004), A Meta Analysis of Innovation and Organizational Size, *Organization Studies*, 25 (3)

Grover, V., Davenpont, T.H., (2001), General Perspectives on Knowledge Management: Fostering Research Agenda, *Journal of Management Information Systems,* 18 (1)

Hoskisson, E.R., Eden, L., Lau, M.C. and Wright, M. (2000), Strategy in Emerging Economies, *Academy of Management Journal*, Vol. 43, No. 3

Dunning, H.J. and Pitelis, N.C. (2008), Stephan Hymer's Contrubition to International Businss Scholarship: An Assessment and Extension", *Journal of International Business Studies*, 39

Jhonston S. And Mengüç B., (2007), Subsidiary Size and the Level of Subsidiary Autonomy in Multinational Corporations: A Quadratic Model Investigation of Australian Subsidiaries" *Journal of International Business Studies*, 38 (2)

Hedlund, G., (1981), Autonomy of Subsidiaries and Formalization of Subsidiary Relationship in Swedish Multinational Corporations, in L. Otterbeck (ed) The Management of Headquarters: Subsidiary Relationships in Multinational Corporations, Gower: Aldershot

Knight, G.A. and Çavuşgil, S.T. (2004), Innovation, Organizational Capabilities and the Born-Global Firm, Journal of International Business Studies, 35 (2)

Cool,K. And Henderson, J, (1998) Power and Firm Profitability in Supply Chains: French Manufacturing Industry in 1993, *Strategic Management Journal,* 19 (10)

Makino,S., Lau, C.M., Yeh, R.S., Asset-Exploitation Versus Asset-Seeking: Implications for Location Choice of Foreign Direct Investment From Newly Industrialized Economies, *Journal of International Business Studies*, 33, 3, 2002

Negandhi, A.R., and Baliga, B.R., 1981, Internal Functioning of American, German and Japanese Multinational Corporations, in L. Otterbeck (ed) The Management of Headquarters: Subsidiary Relationships in Multinational Corporations, Gower: Aldershot

Paterson, S.L., and Brack, D.M., (2002), The Development of Subsidiary-Management Research: Review and Theoretical Analysis" *International Business Review*, 11 (2)

Dunning, J.H. (1977), Trade, Location of Economic Activity and MNE: A Search for an eclectic approach, in; Ohlin, B., Hesselbaum, P.O. and Wijkman, P.M. (ed.) The International Allocation of Economic Activity, Macmillan, London

Dunning, J.H. (1981), International Production and the Multinational Enterprise, George Allen and Unwin, Londra

Dunning, J.H. (1988), "The Eclectic Paradigm of International Production, *Journal of International Business Studies* (19)

Dunning, J.H. (1993), Multinational Enterprises and Global Economy, Addison-Wesley: Wokingham.

Chen, H. And Chen T.J. (1998), Network Linkage and Location Choice in FDI, *Journal of International Business Studies*, 29 (3)

# *STRATEGIC HUMAN RESOURCE MANAGEMENT & ORGANIZATIONAL BEHAVIOR*

# THE RELATIONSHIP BETWEEN STRATEGIC MANAGEMENT, HUMAN RESOURCE MANAGEMENT AND KNOWLEDGE MANAGEMENT IN HIGHER EDUCATION INSTITUTIONS

**Loganathan Narayansamy Govender**

**University of KwaZulu- Natal**

## ABSTRACT

***Purpose:*** *This paper is an attempt to provide an overview of the challenges faced by higher education institutions (HEI's) in addressing the need to manage knowledge as a strategic organisational asset. The paper highlights the close relationship between strategic management, human resource management and knowledge management and the need for the integration of these disciplines to maximise the benefits of knowledge management initiatives in HEI's.*

***Design/methodology/approach:*** *The paper identifies the challenges facing HEI's in the 21st century due to the major knowledge drain as a result of the ever increasing loss of skills through the exodus of qualified and skilled employees. This is followed by a brief literature overview of the key variables impacting on the paper. The paper culminates in devising an integrated model in supporting HEI's in the pursuit of HR related knowledge management strategies.*

***Findings:*** *It is established that if knowledge management is given prominence and viewed as a strategic tool for management and human resource management, major benefits could be realised for the future success and competitiveness of HEI's.*

***Originality/value:*** *This paper would be of significant value to HEI's wishing to implement knowledge management strategies within their HR Administration function. The model proposed could be tested, adapted and implemented to derive realistic benefits.*

***Keywords:*** *Management, Human Resource Management, Knowledge Management*
***Paper type:*** *Literature review*

## INTRODUCTION

An important objective of the paper is the development of a strategic integrated model that demonstrates the relationship between strategic management, strategic human resource management and knowledge management at higher education institutions. The variables and factors represented in the comprehensive model were derived from the literature review, examination of case studies and international best practices.
The paper identifies the continuing decline in skills and knowledge profiles in organisations due to the exodus of experienced professional employees in higher education institutions. The concern is that the knowledge that they take with them far supersedes the knowledge that remain behind. The employees who replace those severed from the higher education institutions are generally lesser skilled, and without the requisite knowledge levels of the predecessors. This leads to a situation where the organizations suffer a "knowledge paralysis" and therefore urgent solutions to the identified problems are sought. One such solution to the problem is the transfer of knowledge from those who are highly knowledgeable, skilled and able to those who are lesser qualified relatively, but with the potential and the need to acquire such knowledge in the performance of their functions. Transfer of knowledge to a wider spectrum of employees will enhance the capability of the organization and lead to increased competitiveness. If individual knowledge can be converted to organizational knowledge, the circulatory knowledge from skilled and experienced employees to the younger and inexperienced will no doubt have a significant impact on the future of the organization. The model will propose an integrated knowledge and human resource

management system that will have strategic benefits for the purpose of making knowledge accessible to all employees in higher education institutions with relative ease.

# 1. Challenges for Human Resource Management

The 21st century heralds a new approach to human resource management where employees are regarded as investments that would provide long-term rewards to the organization if effectively managed and developed (Carrell, Elbert & Hatfield, 2000: 7). Knowledge is a factor of production with a value greater than traditional land, labour or capital. It is therefore the responsibility of human resource management to capture intellectual capital, codify it and transfer it to the other employees in need of such knowledge. It is considered as "HR's challenge to provide a blue-print of how to put knowledge to work as a source of competitive advantage (Davenport & Prusak, 1998:24)".

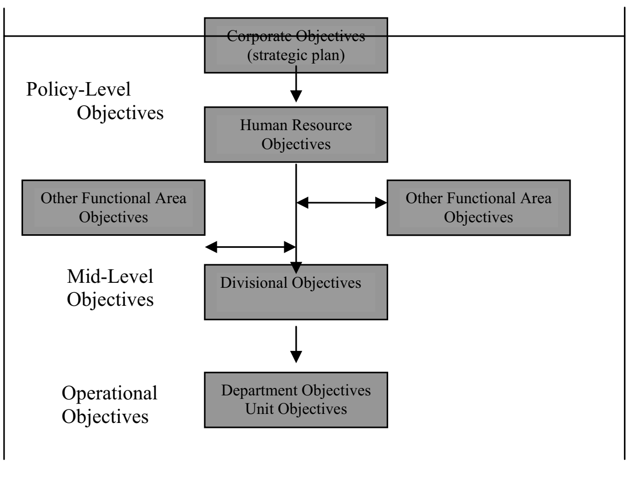
In order to address these challenges, it is important to review the role of human resource management to take into account the value of knowledge and institutionalize mechanisms that would be able to lever this strategic asset for the benefit of the organization.

# 2. The Strategic Alignment of Human Resource Management

Human resource managers need to play new and innovative roles due to the dramatic changes in the internal and external environments. In order to be successful, HRM professionals must link its objectives, policies, systems and practices with the strategic objectives of the organization (Martell & Carroll, 1995: 253).

Figure 1.1 illustrates the integration of the human resource and other functional area objectives with the corporate objectives of the organization.

FIGURE 1.1 INTEGRATION OF HUMAN RESOURCE OBJECTIVES




SOURCE: Anthony, Perrewe & Kacmar, 1999: 141

Ackerman (1989) posits the view that those organizations that align its core functions with the corporate strategies derive the following distinctive benefits:-

- Contribute to the survival and goal accomplishment of the organization;
- Support the implementation of the corporate and business strategies of the organization;
- Create and maintain the competitiveness of the organization;
- Enjoy representation at top management level and participate in strategic planning and influence the strategic direction of the organization; and

- Foster cooperation between the human resource department and line managers.

Central and the main contributors to the abovementioned benefits are the employees and their knowledge. Despite rating employees as the organisation's greatest asset in official records, it is the cost on the profit and loss account that attracts greater attention. Employees are most often regarded as a cost to cut when the times get tough (Skyrme, 2008:1).

# 3. Development of a Model of an Integrated Knowledge Management and Human Resource Management Strategy for Higher Education Institutions

Information that have been extracted during the literature search and the inferences that have been drawn as a result of the search will be used as points of departure for the design of a model that integrates knowledge management and human resource management for implementation at higher education institutions. The proposed model will not purport to represent any existing methods for the integration of strategic management, strategic human resource management and knowledge management. Neither will the model and the proposed processes condemn any existing approaches that are currently applicable to higher education institutions. The proposed model will endeavour to expound a set of basic points of departure within the framework of higher education institutions. The model could be utilized for the enhancement, adjustment or replacement of existing models or systems currently in place for the benefit of the human resource management in its knowledge management integrated practices. The model could be used as a guide to the executive management at higher education institutions to serve as a control measure whereby the integrated human resource management and knowledge management outputs could be measured.

The approaches linked to the integrated model could assist to maintain and enhance the corporate strategy and the mission statement of the higher education institution. Simultaneously it could serve as a motivation for the executive management and the human resource management to ensure that the KM/HRM integrated model will contribute to the realization of the provisions of the institutions strategic plans on a continual basis.

In order to create models of efficiency and effectiveness for KM/HRM integrated systems, it is appropriate to evaluate the capabilities of existing employees at higher education institutions.

## 3.1 Human Resource Management at Higher Education Institutions

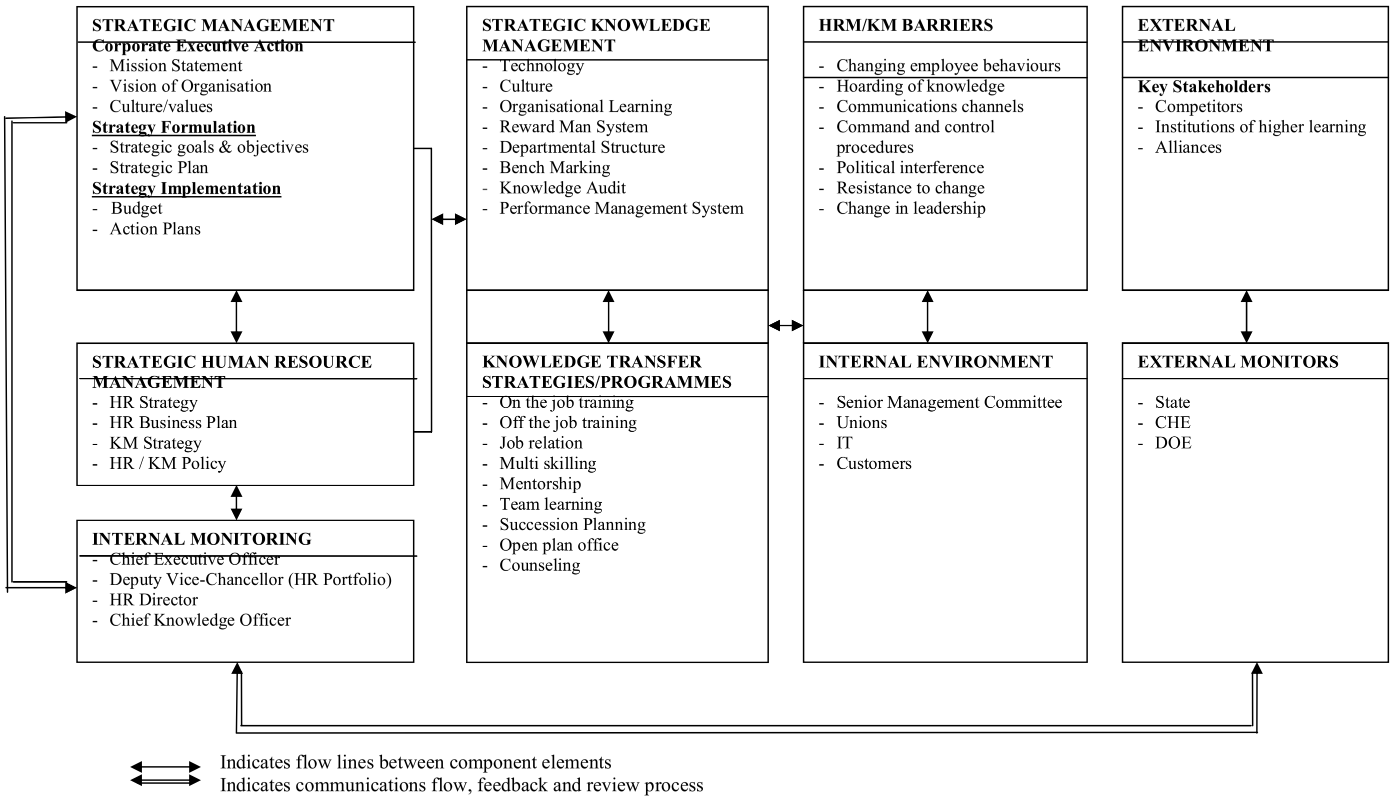
Majority of employees at higher education institutions have permanent appointments and thus have a tendency to believe that they have a lifelong employment contract with the institution. Employees who have scarce skills tend to be attracted to competitors. This situation is exacerbated by the exodus of quality employees to other countries due to a multitude of reasons. According to a Work in Life (WIL) survey conducted by Sunday Times newspaper in 2002, seventy two percent of the readers responded that they would consider emigrating from South Africa. As the respondents come from a well-educated and high earning background, the brain drain will no doubt result in a loss of critical skills and knowledge (Lee, 2004: 3). Higher education institutions suffer similar experiences in competing for scarce resources in a market which has a high unemployment rate and a huge shortage of skilled employees.

From the state level in South Africa, executive mandates via the Minister of Education to higher education institutions have led to the mergers of like institutions within the region, leading to reduced operating costs, circumventing the duplication of services and enhancing cost effectiveness and service delivery. This has forced institutions to re-examine their internal business methods and develop strategic plans as a commitment to transforming higher education institutions. Senior management has therefore demonstrated their commitment to enhancing the quality of institution-wide service delivery.

However, as higher education institutions respond to the ever-increasing pressures to improve performance and reduce costs, managers turn to their support staff for results which are most often beyond their capabilities as they have neither received the training nor have the desired knowledge to be able to deliver quality services. This position is accentuated by the World Competitiveness Yearbook results of 2007 where South Africa ranked 50$^{th}$ out of the 55 countries surveyed in the human resource development category (IMD World Competitiveness Yearbook, 2007). The IMD has issued a stern warning to those nations that are losing ground, such as South Africa, in stating that "these nations will, sooner or later, lose their standing in world competitiveness if they do not improve their overall performance".

It is therefore the responsibility of senior management to recognize the perceived deficiencies and manage the process of integrating knowledge management initiatives with human resource management as a step towards addressing the problem. Failure to do so will have a detrimental effect on institutions in terms of service delivery as well as its image.

**Figure 1.2 Model of an Integrated Knowledge Management / HRM Strategy**



The model in Figure 1.1 enshrines the most important variables that impact on the paper. The model stresses the point that if the higher education institution is to function successfully, senior management must acknowledge the relationship between corporate objectives and human resource management objectives. Rothwell and Kazanas (1988:15) claim that this relationship does not exist in all circumstances for the following reasons:-

- Senior managers do not see the need for this relationship;
- Human resource information is not compatible with other information used in strategy formulation; and
- Senior management and human resource management are in conflict between human resource short term and long term objectives.

As a means of addressing the shortcomings identified, Figure 1.1 expresses the importance for the human resource management objectives of the organization to be linked to the various sub-objectives of the broad functional areas that report to the human resource department such as the human resource administration, human resource development, industrial relations and human resource information systems functionaries. This relationship between the strategic objectives of corporate management, human resource management and the sub-objectives of the functionaries of the human resource department will enable these objectives to operate sequentially and holistically.

The proposed model represented in Figure 1.2 stresses the importance of developing a relationship between senior management and human resource management in order for the model to be effective. The model will strive to create a link between corporate strategies, human resource management strategies and its integration with knowledge management with the primary objective of improving overall organizational performance.

## 3.2 Description of the Integrated Strategy Model

The model in Figure 1.2 reflects broad categories and these are represented in frames. The arrows points out the link between the broad category and the elements within the category as well as the linkage between categories and the elements within the respective categories. The main category frames impacting on the integrated HR/KM strategic model are as follows:-

- Strategic management
- Strategic human resource management
- Strategic knowledge management
- HRM/KM barriers
- External environment

The important features reflected within each broad category frame represent the core elements of the model with each element labeled with a sub-heading. The interconnection between the broad categories and within and between elements is illustrated by arrows.

## 3.3 Responsibility for Strategic Management at HEI's

According to Kroon (1994:13) strategic management is usually conducted by top management comprising of the board of directors, the chief executive officer, and other senior managers who together make up the management committee. Oosthuizen (1981:39) states that a higher educational institution "is a most complex institution". The top organizational structure of higher educational institutions comprises of the Chancellor, who is the titular head. The Rector (or Principal) and Vice-Chancellor is the active head, who is also the chief executive officer of the institution and "officiates under the jurisdiction of the Council, which directs the operations of the institution". Members of the management committee shall include the Vice-Chancellor, the Deputy Vice Chancellor/s, the Registrars, and other senior office bearers in the administration. Strategic management is the responsibility of the management committee and any other persons co-opted to the strategic management committee.

## 3.4 Strategic Management

The first element under strategic management is the institution's vision and mission statement. The vision statement outlines the goals of the organization. It describes in an artistic manner the direction that the institution wishes to pursue. The time frame for a vision statement is five years during which period a review is conducted (Schultz et al, 2003:251).

## 3.4.1 Mission Statement

The formulation of the mission of the organization is the responsibility of top management. The mission determines the reason for the existence of the organization. It is future-orientated and defines the organization's service industry, its market, and management philosophy (Pearce & Robinson, 1985:79). Nel et al (2004:524) states that the mission encapsulates a general plan on how the organization intends achieving its goals and objectives. There is also a close relationship between the mission of the organization and its culture.

## 3.4.2 Management Strategy and Corporate Culture

Mitchell (1990:56) is of the view that management strategy and corporate culture are closely related. The culture of the organization and corporate strategy are mutually inter-dependant. New management brings new cultures, and new cultures breed new strategies. Often personalities clash with culture and this must be managed with great sensitivity. During horizontal mergers, culture clashes lead to major failure. Two different philosophies collide with one insisting that the other conform. As a result, the combined merged organization tends to suffer huge losses. It is therefore recommended that during mergers, individual organizations commit to creating an entirely new organization with a combined culture building on the strengths of the former organizations. Senior management must therefore be cognizant of the dynamics of the strategy/culture relationship in organizations.

## 3.4.3 Strategy Formulation

Strategy formulation refers to long term planning by the top management. Anthony et al (1999:10) define strategy as "the formulation of organizational missions, goals, and objectives, as well as action plans for achievement, which explicitly recognize the competition and the impact of outside environmental forces". Strategic formulation is a dynamic process where action sometimes dictates the strategy to follow and vice versa. It is subject to change depending on the environmental factors, competition or internal politics. According to Nel et al. (2004:527), the mission statement of an organization should ideally encapsulate the following elements.

### 3.4.3.1 Goals and objectives

Goals are a desired result that an organization strives for. It is part of the mission of the organization and not finitely defined. Goals guide groups and individual employees to achieve the maximum output with the least input. Therefore goals direct performance or results. Whilst goals are long term, objectives are short term performance targets. Objectives are based on the goals of the organization and contribute to the attainment of the goals. Objectives are normally deadline date driven for the attainment of results (Kroon, 1994:149).

### 3.4.3.2 The Strategic Planning Process

According to Quin (1980:7) the strategic planning process involves the integration of an organisation's major goals, policies, and action sequences into a cohesive whole. Higgins & Vincze (1989) cited in Greer (2001:125) concurs with this definition and adds that the strategic planning process generally adopted the following steps:-

- Development of a mission statement;
- Environmental scanning;
- Analysis of strengths, weaknesses, opportunities, and threats (SWOT analysis);
- Formulation of strategic objectives;
- Alternative strategies for achieving objectives; and
- Selection of strategies after due evaluation.

The framework of the integrated model, presented in Figure 1.2 begins with the organizational mission statement with a view to guiding managerial decision-making. According to Greer, 2001:xv) the organisation's mission, strategy and goals "provides a rational, financially justifiable basis for analyzing the value of alternative human resource strategies, policies, and practices". In order to meet the challenges of improving service delivery at higher education institutions, it is necessary to conduct an evaluation of the human resources department.

### 3.4.3.3 Need to Evaluate the Human Resource Function

According to Cashman & McElroy (1991:70-73) a study at the University of Iowa revealed that approximately one-third of the organizations in their survey seldom or never conduct evaluations of their human resource departments. Another one-third indicated that they conduct human resource reviews at least annually, whilst

the final one-third fell somewhere in the middle. The main reasons cited for not evaluating the human resource function were the difficulty in conducting a scientific evaluation for quantifying the human resource function. However, those that conducted evaluations indicated that they used a more judgmental and qualitative process rather than a quantitative or scientific process. It was also established in the survey that the majority of the institutions which had a system of evaluation, actually evaluated the human resource function internally within the human resources department. The results of the survey revealed that the evaluation was not conducted properly, and consequently the informal information gathered was insufficient to determine the actual level of service rendered by the human resource function.
It is therefore concluded that procedures must exist to determine the quality of service rendered by the human resource staff functionary. A human resource audit is an important tool to evaluate service levels as well as the effectiveness of policies, programmes and practices in the human resource department.

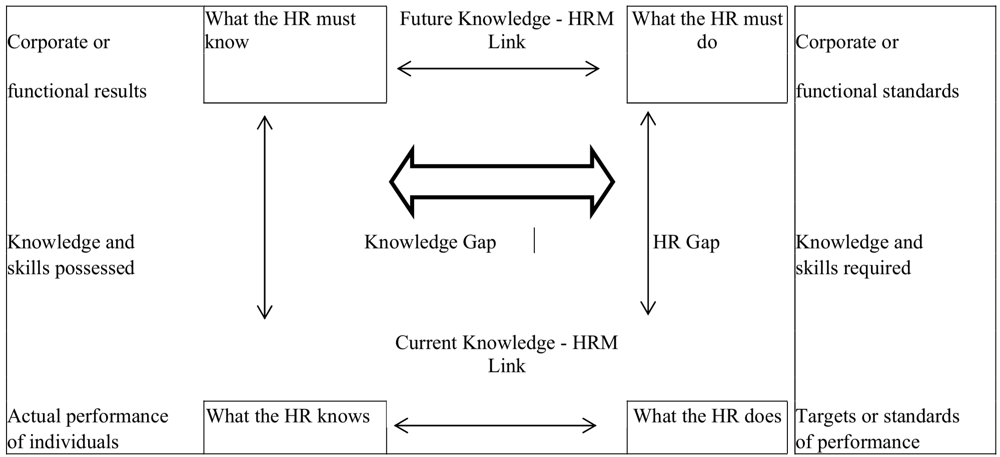
## 3.4.3.4 The Human Resource Audit

Human resource audit is one method of assessing the effectiveness and efficiency of human resource employees in terms of servicing the human resource needs of the organization. This process helps the organization to analyze the effectiveness of its human resources policies and practices and to determine whether changes or improvements are necessary (Mathis & Jackson, 1988:599).
According to Seagal &Quin (1989:67) a human resource audit becomes necessary when management perceives that human resource programmes and policies are not meeting the goals of the organization. For a human resource audit to be effective, the organization must determine what it seeks to achieve by performing it. This process will determine who is to perform the audit and the methods to be followed in conducting it. The audit team could comprise in-house employees in view of their familiarity with the organization. However, the disadvantage is that they may perpetuate past errors. Engaging an external consultant may yield innovative solutions to the project. However the obligation is on senior management to decide which option best meets its needs.
Anthony et al (1999:100-101) avers that the human resource audit involves collecting data through a number of methods such as observations, surveys, questionnaires and computer data reviews. The audit techniques are used to gather information and benchmark these to some expected or predicted outcome.
The idea of the audit process is to evaluate the various knowledge management/ human resource related programmes to determine their effectiveness in relation to the corporate and human resource strategies.
Once the service levels and the KM/HR programmes and policies are evaluated it is important to determine where these policies are to be implemented. It is therefore necessary to conduct a knowledge needs analysis to provide a map of the level of knowledge, skills and abilities of employees within the organization.

## 3.4.3.5 Knowledge Needs Analysis

According to Mills, Pace & Peterson (1988:5) cited in Meyer (2002:115), analysis is defined as “the act and process of separating any material or abstract entity into its constituent elements, which involves determining its essential features and their relations to one another”. In the context of knowledge management, a knowledge gap is the difference between what knowledge employees have, and the knowledge that is required in order for the employees to perform their functions optimally. Figure 1.3 illustrates the knowledge gap approach.

Figure 1.3. Knowledge Gap Approach




Source: Adapted from Gottshalk (2005:76)

A need should ideally be identified as the essential knowledge, skills and attitudes that an employee must possess in order to perform duties competently to accomplish desired results. A knowledge needs analysis therefore is a process of identifying an issue or a problem, through the collection, analysis, and interpretation of data; and using the information obtained to select or design appropriate knowledge management/human resource interventions to address the issue or problem (Meyer, 2002:115).
Once the knowledge needs analysis is conducted by the human resources department, the actual knowledge level of all employees in the organization will have been established. The desired knowledge of each job category could be ascertained from the job analysis and the job description. The difference between 'what is', and 'what should be' (refer to Figure 1.3) will constitute knowledge gaps. Before the selection and design of knowledge interventions to address the identified knowledge gaps, it is important to undertake a knowledge competency analysis to determine the actual knowledge required by an employee to be able to render a task competently.

## 3.4.3.6 Knowledge Competency Analysis

A knowledge competency analysis involves an in-depth analysis of the knowledge necessary to be able to perform each of the tasks associated with a job. Mager (1988:41) advocates that when considering such analysis, it is necessary to commit in writing the knowledge that the employee would require in order to perform a task. This knowledge list constitutes the areas in which knowledge interventions need to be designed and implemented. This list could also be categorized into pre-requisite knowledge, and requisite knowledge. Meyer (2002:127) posits that pre-requisite knowledge must be acquired before implementing interventions to address acquisition of requisite knowledge. This could be achieved by creating a knowledge hierarchy which clearly highlights pre-requisite knowledge. According to Rothwell & Kazanas (1992: 129-130) cited in Meyer, one method to identify knowledge needs is to repeatedly enquire of each task and sub-task of the job incumbent "what does the learner need to know to do that?" The responses could then be represented in a flowchart so that successors to the tasks could use it as a knowledge map.
Having established the knowledge gaps and the pre-requisite and requisite knowledge needs hierarchy in the organization, the next phase of the developmental model is to determine some of the causes of the knowledge deficiencies.

## 3.4.3.7 Knowledge Gap Cause Analysis

The next step in the model (Figure 1.2) focuses on the identification of some of the causes of knowledge deficiencies in organizations. It is important that top management identifies these causes and addresses such impediments to ensure the success of the knowledge empowerment strategies. Some of the causes could include the following factors.

## 3.4.3.8 Organisational Culture

The challenge for management is to align the culture with the strategic direction of the organization. Culture could be a major obstacle and contributor to knowledge gaps in organizations. According to Beer, Eisenstat & Spector (1990), outstanding results could be achieved when employees share common beliefs and subscribe to common norms of behaviour. Tobin (1998:33) is of the view that organizational culture could act as a barrier to sharing knowledge between and amongst employees. When organizational culture promotes a competitive "winner-take-all mentality" employees are encouraged to hoard knowledge so that they have an edge over others in competing for rewards. In addition, organizations tend to discourage the use of external knowledge. The "not invented here" myopic vision of management prevents employees from seeking external knowledge to solve organizational problems. Hence benchmarking human resource management practices against leading organizations is prevented in the process.

## 3.4.3.9 Organisational and Departmental Structures

Closely linked to organizational culture are organizational and departmental structures. Poorly designed structures could stem and prevent the flow of knowledge amongst employees both vertically and horizontally. According to Walker (1992:134) "organizational structure accommodates and nurtures informal relationships and networks that provide for effective information flow and influence". Flexible structures empower employees to act and nurture teamwork. Flexible structures encourage communication flow and cooperation amongst employees bringing about a highly motivated teamwork, improved response and turnaround time, and a "turned-on work force". Therefore flexible structures foster networks of relationships so necessary in a knowledge economy. Although formal hierarchies exist in flexible structures, the work gets done because employees interact in teams and work directly with each other. Flexible structures are flat, lean and fluid.

Knowledge flows freely amongst employees in flexible organizations, supported by direct access to information systems.

## 3.4.3.10 Implementation Barriers

Fahey and Prusak (2000) have identified several implementation errors, and state that if these are not managed and corrected, genuine knowledge could be prevented from being developed or leveraged. They rate these errors as the "deadliest sins of knowledge management". These barriers would have major implications for human resource management.

- **Working definition of knowledge**: Human resource management (HRM) must differentiate between data, information and knowledge. It is therefore important for human resource departments at higher education institutions to develop a working definition of knowledge so that employees could identify with this phenomenon.
- **Knowledge flow**: Knowledge is dynamic and is in constant flux and change. Therefore knowledge must be adjusted with the latest updates to ensure that it remains current.
- **Tacit knowledge**: The role of tacit knowledge is downplayed in organizations. Tacit knowledge plays a crucial role in influencing explicit knowledge. Therefore interventions to facilitate the transfer of tacit knowledge to other employees or devise methods to capture such knowledge must be sought.
- **Focus knowledge on future**: Knowledge generation and its use is a never ending cycle. Management tends to focus knowledge on the past and the present but fail to exploit it for future benefit. The purpose of knowledge is to inform and influence decision-making and therefore must be future orientated.
- **Encourage experimentation**: Encouraging employees to do things differently have significant benefits for the organization. A new and innovative approach to the interpretation of data and information, and initiation of pilot projects leads to the creation of new knowledge.

## 3.4.3.11 Technology

The benefits of technology in human resource management is an enabling tool and if used for the purpose of knowledge management techniques, it can lead to improved decision making capabilities, reduced turn-around time, improved administrative services, and reduced costs. In this regard it is important for human resource management to work with the information technology department to determine how best to organize, store, and retrieve organizational knowledge. According to Alavi and Leidner (2001), empirical studies have confirmed that whilst organizations create knowledge, such acquired knowledge is forgotten over a period of time. Therefore such knowledge has to be committed to organizational memory. Computer technology is an effective tool in enhancing organizational memory and accessing it whenever the need arises. Gottschalk (2005) notes that groupware is a useful intra-organizational memory tool to share both structured and unstructured knowledge across time and space.

## 4. Summary

This chapter presented a model that linked and integrated knowledge management with corporate strategy and human resource management for application at higher education institutions. The model has attempted to shed light on some important characteristics of knowledge management and human resource management. The model critically evaluated knowledge as a strategic resource. Potential barriers to the implementation of knowledge management practices in human resource management at higher education institutions were identified.

Although knowledge as a strategic resource is difficult to manage, the proposed model argues that if the steps outlined are followed, this situation could be turned around. A careful selection of knowledge transfer mechanisms will help realize immense benefits for human resource management and the higher education institutions as a whole.

# REFERENCES


Ackerman, P.L. (1989), Individual differences in skills learning: An integration of psychometric and information processing perspectives. **Psychological Bulletin,** 102, 3-27.

Alavi, M. and Leidner, D. (2001), Review: Knowledge Management and Knowledge Management Systems: Conceptual foundations and research issues, **MIS Quarterly**, Vol. 25 No.1, pp 107-136.

Anthony, W.P., Perrewe, P.L. & Kacmar, K.M. (1999), **Human Resource Manangement: A Strategic Approach.** 3rdEdition. Fort Worth: The Dreyden Press.

Carrell, M.R., Elbert, N.F., & Hatfield, R.D. (2000), **Human Resource Management: Strategies for Managing a Diverse and Global Workforce,** 6th Edition, USA: The Dreyden Press, Harcourt College Publishers.

Cashman, M. & McElroy, J. (1991) Evaluating the HR Function. **HR Magazine,** Vol. 1.

Davenport, T. & Prusak, L., (1998), **Working Knowledge,** Boston: Harvard Business School Press.

Eisenstat, R & Spector, B. (1990), **Critical Path to Corporate Renewal.** Harvard Business School Press. Boston

Fahey, L (2000), The eleven deadliest sins of knowledge management. **California Management Review**, Vol. 40 No. 3 pp265-75

Gottshalk, P. (2005), **Strategic Knowledge Management Technology.** Idea Group Publishing

Greer, C.R. (2001), **Strategic Human Resource Management: A General Managerial Approach.** 2nd Edition, USA: Prentice Hall

Higgins, J.M. & Vincze, J.W. (1989), **Strategic Management: Text and Cases.** Dreyden Press.

Kroon, J. (1994), **General Management,** HAUM Tertiary, Pretoria.

Lee, N. L. (2004), **Knowledge Management: Its application in IT projects.** South Africa: Zytek Publishing (Pty) Ltd.

Mager, R.F. (1988), **Making Instruction Work.** Belmont: David Lake.

Martell, K. & Carroll, S.J. (1995), How strategic is HRM? **Human Resource Management,** 34(2): 253.

Mathis, R.L. & Jackson, J.H. (1988), **Human Resource Management.** 5th Edition. St. Paul, Minn.West.

Meyer, M.(2002), **Managing Human Resource Development: An Outcomes-Based Approach.** 2nd Edition. LexusNexis Butterworths, South Africa.

Mills, G.E., PaceR.W. & Peterson, B.D. (1988), **Analysis in Human Resources Training and Organisation Development.** Reading:Addison-Wesley.

Mitchell, R. (1990), Can Cray re-program itself for creativity**, Business Week,** August 20: 86.

Nel, P.S., Van Dyk, P.S., Haasbroek, G.D., Schultz, H.B., Sono,T.J., & Werner, A. (2004), **Human Resource Management**. 2nd Edition. Oxford University Press, USA.

Oosthuizen,G. C. (1981). **Challenge to a South African University: The University of Durban-Westville.** Cape Town: Oxford University Press.

Pearce, J.A. & Robinson, R.B. (1985), **Strategic Management: Strategy Formulation and Implementation.** 2nd Edition. Homewood, Illinois: Richard D. Irwin.

Quinn, J. B. (1980), **Strategies for Change: Logical Incrementalism.** Homewood,IL: Richard D. Irwin.

Rothwell W.J. & Kazanas H.C. (1992), **Mastering the Instructional Design Process.** San Francisco: Josey-Bass.

Schultz, H., Bagraim, J., Portgieter, T., Viedge, C. & Werner, A. (2003), **Organisational Behaviour. A contemporary South African perspective.**

Seagal, J.A. & Quin, M.A.(1989), How to Audit your HR Programs. **Personnel Administrator,** Vol.5

Skyrme, D.J. (2008), **Are exit interviews the wits end?,** (http://www.skyrme.com/updates/u55_fl.htm) (17 August 2008).

Tobin, D.R. (1998), **The Knowledge Enabled Organization.** New York: AMACOM.

Walker,J. (1992), **Human Resource Management: Theory and Practice.** New York: McGraw-Hill

# THE EMPLOYEE SATISFACTION IN BANKING SECTOR: THE DIFFERENCES BETWEEN THE EMPLOYEES IN VIRTUAL BANKING AND IN THE BRANCHES

**Fatma Zehra Savi**
**Kastamonu University, Turkey**
**Murtaza Önal**
**Halkbank, Turkey**

## ABSTRACT

*This study attempts to evaluate job satisfaction of bank employees in Turkey. It focuses on the relative importance of job satisfaction factors and their impacts on the overall job satisfaction of employees. It also investigates the impacts of work experience, age, and sex differences on the attitudes toward job satisfaction. The result shows that salary, efficiency in work, fringe supervision, and co-worker relation are the most important factors contributing to job satisfaction. Branch employees have higher levels of job satisfaction than those of virtual banking as they enjoy better facilities and supportive work environment. Work experience is found as the second most important factor affecting job satisfaction. Sex and age differences have relatively lower level of impact on it. The overall job satisfaction of the bank employees is at the positive level.*

## INTRODUCTION

Employee satisfaction is defined as the combination of effective reactions to the differential perceptions of what he/she wants to receive compared with what he/she actually receives (Cranny, Smith, & Stone, 1992). Therefore, the organizations should try to fulfill the employee expectations in order to achieve the desired levels of the employee satisfaction. In addition, emotional state of the employees may also affect their satisfaction. This compels the managers to create and sustain positive working environments within the organizations.

The changes have manifested themselves in technological, scientific, social and cultural aspects of the society by passing through different phases from ancient times up to the present. Therefore it could be stated that the nature of the society is not only static but also open to every kind of change.

People join various organizations in most part of their lives. The organizations are strong social tools for arranging the relationships between the individuals. They are composed of two or more people to achieve behaviors are managed according to specified rules (Applewhite, 1965). Another definition states that organizations are goal directed, boundary maintained, and socially constructed systems of human activity, which focuses attention on the social processes involved in the genesis and persistence of organizations (Aldrich, 1999). When an individual wants to achieve his goals which require more power than he has, then cooperation (with others) is an asset. It is understood from these statements that the organizations satisfy the individuals' needs through interactive and collaborative working processes. Just like the individuals, the organizations also collaborate with other organizations, and that is why, they must be aware of the events taking place outside their organization. The complexity of environmental changes forces firms to search efficient operational exploration for their development process. This means, improvement of the efficiency will play an important role in accelerating the development of the organizations. Effective organizations should have a culture that promotes the employee satisfaction (Bhatti & Qureshi, 2007).

Virtual banking is broadly defined in this paper as the provision of banking services performed without traditional physical branches. At present, virtual banking activities exist in the forms of ATM, phone banking, home banking and Internet banking. Virtual banking can help financial institutions to formulate appropriate marketing strategies for new forms of banking by understanding depositors adoption and needs.

# METHODOLOGY

The main objective of the study is to identify the level of job satisfaction of bank employees in Turkey. Bank employees in this study refer to first and second class employees (not third and fourth class employees such as, clerks, assistants, peons, guards, drivers, cleaners etc.) . The specific objectives are (i) to identify the relative importance of job satisfaction factors; (ii) to identify the impact of Bank type, work experience, age, and sex differences on the attitudes toward job satisfaction; and (iii) to differentiate the level of job satisfaction between virtual and branch bank employees in Turkey. To achieve these objectives 129 bank employees were surveyed. Subjects include 75 bank employees from virtual and 54 from branches.A structured questionnaire in a 7-point scale was used in the survey. In the measurement, scale 1 indicates strongly disagree and 7 indicates strongly agree. Considering the respondents' freedom of choice, subjective explanations of the numbers between the bipolar scale were not provided. The reliability test was conducted to verify the internal consistency of the variables obtained through the questionnaire. The Cronbach's alpha value ($\alpha$) is found 0.8677, which is higher than the minimum acceptable level suggested by Nunnally (1978). Several multivariate analysis techniques such as, Factor Analysis, Multiple Regression Analysis, ANOVA were used to measure the level of job satisfaction of bank employees in Turkey.

# RESULTS AND DISCUSSIONS

The study deals with three issues to analyze the job satisfaction of bank employees in Turkey. These issues are: (i) the relative importance of job satisfaction factors; (ii) the impact of bank type, work experience, age and sex differences on the attitudes toward job satisfaction; and (iii) the level of differences in job satisfaction of virtual and branch employees.

Factor analysis of 26 variables in the instrument formed eight main factors with eigenvalues greater than one (Table 1). The eigenvalue of last factor (work ability) contains the value of 0.997, which is accepted as close to one.These 8 factors account for 67.31% of the variance in the data on attitudes toward job satisfaction. The first factor, salary, that accounts for the most variance (27.19%) consists of eight variables. Eigenvalue for this factor is 7.069, which indicates that this factor contains more information than the other factors. This factor provides the maximum insights of job satisfaction
of bank employees in Turkey. It broadly includes the areas of job satisfaction such as salary, company policies and practices, and promotion chance. The eight variables contained in the factor "salary" are: satisfied with present salary, bank is sympathetic to the officers view, bank appreciates performance, satisfied with increment allocation method, income is higher than other banks, satisfied with the chances of promotion, satisfied with the welfare facilities, and satisfied with the chances of income increase. The mean values of these eight variables are 4.30, 4.30, 4.20, 4.16, 3.94, 3.78, 3.60, and 3.89 respectively. In the 7-point scale these mean values represent somewhat neutral to positive level of job satisfaction. Hence, the policy makers in the banking sector in Turkey should attach greater importance to these variables concerning salary, company policies and practices, and chance for promotion to increase job satisfaction of the employees.

**Table 1 Factor Analysis: Job Satisfaction of Bank Employees in Turkey**

| Factors* | Variables | Loadings | Variance % (Cumulative) |
|---|---|---|---|
| Salary (7.069) | Satisfied with present salary,<br>Bank is sympathetic to officers view,<br>Bank appreciates performance,<br>Satisfied with increment allocation method,<br>Income is higher than other banks,<br>Satisfied with the chances of promotion,<br>Satisfied with the welfare facilities,<br>Satisfied with the chances with the income increase. | 0.827<br>0.656<br>0.660<br>0.643<br>0.824<br>0.725<br>0.785<br>0.846 | 27.188<br>(27.188) |
| Efficiency in work (2.436) | Not loose job if work efficiently,<br>Immediate supervisor is reasonable,<br>Satisfied with recognition by colleagues,<br>Superior appreciates suggestions for improvements. | 0.738<br>0.567<br>0.614<br>0.501 | 9.371<br>(36.559) |
| Fringe benefit (1.670) | Superior pays reasonable attention to suggestions,<br>Satisfied with personnel development programs,<br>Leave rules cover average requirements adequately. | 0.689<br>0.636<br>0.706 | 6.425<br>(42.984) |
| Supervision (1.589) | Satisfied with work allotments,<br>Satisfied with general supervision of departments,<br>Maximum facilities given for working properly. | 0.454<br>0.816<br>0.561 | 6.111<br>(49.095) |
| Leadership style (1.385) | Bank's policy is to override workers to get the maximum,<br>Bank treats officers worse than other banks. | 0.635<br>0.799 | 5.325<br>(54.421) |
| Loyalty to bank (1.289) | Very good relationship between union and management,<br>Would not leave job if similar job offer to other organization. | 0.597<br>-0.676 | 4.690<br>(59.111) |
| Co-worker relation (1.134) | Job offers chances to do things felt best,<br>Prefer to work with present colleagues. | 0.633<br>0.782 | 4.362<br>(63.472) |
| Work ability (0.997) | Fair chances affered for better work,<br>Beging able to do better than present work. | 0.588<br>0.846 | 3.835<br>(67.307) |

***Numbers in the parentheses in the first column represent eigenvalues of the corresponding factors.***

The second important factor is efficiency in work that accounts for 9.37% of the variance and it broadly covers areas of job satisfaction including job security, supervision, and supportive colleagues. The variables are not to lose job if worked efficiently, immediate supervisor is reasonable, satisfied with the recognition by colleagues, and superior appreciates suggestions for improvement. It has an eigenvalue of 2.436. The mean values of these four variables are 5.83, 5.82, 5.24, and 4.92 respectively that characterize a positive job satisfaction of bank employees. Two variables namely immediate supervisor is reasonable and superior appreciates suggestions for improvement have relatively lower factor loading (less than 0.60) that arise suspect about their membership to this factor. The other six factors are almost equal in their ability to account for the variation of level of job satisfaction with comparatively low eigenvalues. The communality values of the variables under eight factors indicate that each variable has a lot in common with other variables that formed the factor (Appendix 1, for details).

Multiple Regression analysis was conducted subsequently with the eight factors as independent variables and overall job satisfaction as dependent variable (Table 2). The inclusion of the eight factors correlate well with job satisfaction (0.795). This could also be interpreted that 63.1% (0.795 square) of the variation in the overall job satisfaction of bank officers can be explained by the eight factors and the remaining 36.9% be explained by other factors. A similarity was observed between the cumulative variance value of eight factors and the R square value. The highlevel of respandentsı education that helped them to respond consistently could explain this. A relatively low standard error value of 1.20 broadens the scope of prediction of the nature of overall bank employees'job satijfaction by the factor scores, as they are lying reasonably close around the regression line. Considering the factors individually, salary, efficiency in work, fringe benefit, supervision, and relations between co-warkers are found highly significant towards the overall job satisfaction of bank employees. It qualifies that the variables related to these factors are important for the job satisfaction of bank employees in Turkey. The contribution of the variables relating to the factors of leadership style, loyalty to bank, and work ability to job satisfaction is found not remarkable.

Table 2 Multiple Regression Analysis of Job Satisfaction Factors on Overall Satisfaction

| Factors | Regression Coefficient | Std. Error Coefficient | Computed t | Significance |
|---|---|---|---|---|
| Salary | 1.18 | 0.11 | 11.01 | 0.00* |
| Efficiency in work | 0.40 | 0.11 | 3.77 | 0.00* |
| Fringe benefit | 0.48 | 0.11 | 4.51 | 0.00* |
| Supervision | 0.42 | 0.11 | 3.90 | 0.00* |
| Leadership style | 0.07 | 0.11 | 0.67 | 0.51 |
| Loyalty to bank | 0.12 | 0.11 | 1.14 | 0.26 |
| Relations between co-workers | 0.58 | 0.11 | 5.39 | 0.00* |
| Work ability | -0.04 | 0.11 | -0.39 | 0.70 |
| Intercept (Constant) | 4.84 | | | |
| Multiple Correlation | 0.795 | | | |
| R-Square | 0.631 | | | |
| Std. Error of Estimate | 1.20 | | | |
| ANOVA for Regression | | | | |
| Sources of Variation | Sum of Square | Degrees of Freedom | Mean Square | Computed F |
| Regression | 292.60 | 8 | 36.58 | 25.25* |
| Residual | 170.93 | 118 | 1.45 | |
| Total | 463.53 | 126 | | |

* Significant

Relative importance of job satisfaction factors on overall satisfaction supports the findings of Multiple Regression Analysis (Table 3). As the leadership style, loyalty to bank, and work ability do not have significant contribution on the overall job satisfaction, an analysis of variance (ANOVA) is carried out. It shows that all eight factors as a whole are highly significant towards the overall job satisfaction of Turkish bank employees.

**Table 3 Relative Importance of Job Satisfaction Factors on Overall Satisfaction**

| | Salary | Efficiency in work | Fringe benefit | Supervision | Leadershi p style | Loyalty to bank | Co-worker relations | Work ability |
|---|---|---|---|---|---|---|---|---|
| Relative Importance (Standardized Regression Coefficient) | 0.616 | 0.211 | 0.252 | 0.218 | 0.037 | 0.064 | 0.301 | -0.022 |

# Impact Of Working Type, Work Experience, Age And Sex Differences On Job Satisfaction

Previous researchers found relationships between job satisfaction and age, sex, (Pugliesi, 1995; Cheung and Scherling, 1999) and work experience (Steffy and Jones, 1990). As MANOVA looks at statistical significance jointly across all the dependent variables at once, the technique was used to assess the significance of the bank type, work experience, sex, and age differences on the entire set of variables towards job satisfaction of bank employees (Karl, 1998). In this section, the impacts of working type, work experience, gender, and age on the attitudes, rather than factors, toward job satisfaction of bank employees is assessed. This has been done with a view to obtaining more insights on the impact. The results show that the variables covary significantly with the type of working – virtual and branch. It means that there is a variation in the level of job satisfaction of bank employees depending on the type of working in Turkey. In other words, type of working is a significant explanatory variable for the job satisfaction level. Fourteen job satisfaction variables, broadly representing the areas of company policies and practices, salaries and facilities, opportunities for promotion, and relationship between virtual and branch, are significantly related to the working type (Table 4).

Work experience has the second most important place out of on four variables taken in the study (job gives chances to have things felt best, satisfied with increment allocation method, income is higher than other banks, and would not leave job if similar job offer to other organization). These variables confirm a significant relationship with experience of bank officers. These relationships broadly indicate that experience affects the areas of job satisfaction including policies and practices (job gives chances to do things felt best and satisfied with increment allocation method), salary and facilities (income is higher than other banks), and loyalty to the company (would not leave job if a similar position is offered by another organization). It could be explained that officers with higher experience hold higher level of work freedom, have more financial and non-financial benefits, are more familiar with organizational policies and practices, and have greater loyalty to the bank.

**Table 4. Multivariate Analysis of Variance, Impact of Working Type , Age, Gender, and Work Experience on Attitudes towards Job Satisfaction**

| Source | Dependent Variables | Sum of Squares | Mean Squares | **F** | Sig. |
|---|---|---|---|---|---|
| Working type (virtual-branch) | Job offerss chances to have things felt best, | 20.679 | 20.679 | 6.609 | 0.011 |
| | Satisfied with present salary, | 135.038 | 135.038 | 48.649 | 0.000 |
| | Fair chances given for better work, | 11.177 | 11.177 | 3.953 | 0.049 |
| | Bank is sympathetic to officers view, | 102.835 | 102.835 | 34.839 | 0.000 |
| | Bank appreciates performance, | 110.507 | 110.507 | 36.065 | 0.000 |
| | Bank's policy is to overdrive workers to get the | | | | |
| | maximum, | 25.021 | 25.021 | 9.215 | 0.003 |
| | Satisfied with increment allocation method, | | | | |
| | Income is higher than other banks, | 65.738 | 65.738 | 20.132 | 0.000 |
| | Satisfied with the chances of promotion, | 171.165 | 171.165 | 62.968 | 0.000 |
| | Satisfied with personnel development programs, | | | | |
| | Very good relationship between union and | 194.220 | 194.220 | 60.823 | 0.000 |
| | management, | | | | |
| | Maximum facilities given for working properly, | 29.226 | 29.226 | 8.507 | 0.004 |
| | Satisfied with the welfare facilities, | | | | |
| | Satisfied with the chances with the income | 81.942 | 81.942 | 29.709 | 0.000 |
| | increase. | | | | |
| | | 26.777 | 26.777 | 9.906 | 0.002 |
| | | 124.555 | 124.555 | 45.822 | 0.000 |
| | | 174.448 | 174.448 | 71.386 | 0.000 |
| Working Experience | Job offers chances to have things felt best, | 27.410 | 27.410 | 8.760 | 0.004 |
| | Satisfied with increment allocation method, | | | | |
| | Income is higher than other banks, | 16.762 | 16.762 | 5.133 | 0.025 |
| | Would not leave job if a similar position is | 13.739 | 13.739 | 5.054 | 0.026 |
| | affered by aother organization. | | | | |
| | | 31.468 | 31.468 | 7.462 | 0.007 |
| Gender (Male-Female) | Bank is sympathetic to officers' view. | 18.083 | 18.083 | 6.126 | 0.015 |
| Age | Bank's policy is to overdrive workers to get the maximum. | 10.788 | 10.788 | 3.973 | 0.048 |

Note: Attitudes affected by various sources at 5% significance level have only been extracted and shown in the Table 4

Sex and age differences have relatively lower level of impact on the entire set of variables, which are manifested through the significance of 'bank is sympathetic to officers views' and 'banks policy is to overdrive workers to get the maximum' respectively in the test. Sex differences only afferct thefactor of(or varialde) the bank's sympathy to the officers' views, while age differences have impact on bank's policy to overdrive workers to get the maximum. Sex differences in particular could be described as an interesting issue in the socio-economic context of Turkey. It is generally viewed that female employees are somewhat neglected in their work places and consequently, they are prone to a relatively lower level of job satisfaction. This study defies this view endorsing almost no sex discrimination in the female bank employees. Age differences of bank employees have also negligible impact on the full set of variables of job satisfaction. None of the interactions from these four factors – working type, work experience, sex, age - was found significant.

## Job Satısfactıon In Virtual Banking and Branches

It is earlier mentioned that the type of working in bank has significant impact on the variables of job satisfaction. However, the analysis does not explicitly show the attitudinal relationship with virtual and branches. To identify this relationship, the study further analyzed mean values of job satisfaction variables along virtual and branches (Table 5).

**Table 5 Description of Job Satisfaction Variables, The Mean and Standard Deviation**

| Job Satisfaction Variables | Mean | | | Standard Deviation | |
|---|---|---|---|---|---|
| | Virtual | Branch | Difference | Virtual | Branch |
| V1: Job offers chances to have things felt best | 4.48 | 5.20 | -0.72 | 1.95 | 1.74 |
| V2: Satisfied with work allotments | 4.66 | 5.03 | -0.37 | 1.98 | 1.74 |
| V3: Satisfied with present salary | 2.87 | 5.35 | -2.48 | 1.83 | 1.57 |
| V4: Fair chances given for better work | 4.22 | 5.16 | -0.94 | 1.98 | 1.46 |
| V5: Not to lose job if worked efficiently | 5.50 | 6.11 | -0.61 | 2.01 | 1.21 |
| V6: Immediate supervisor is reasonable | 5.72 | 5.91 | -0.19 | 1.52 | 1.23 |
| V7: Satisfied with general supervision of departments | 5.41 | 5.67 | -0.26 | 1.67 | 1.42 |
| V8: Satisfied with recognition by colleagues | 5.06 | 5.41 | -0.35 | 1.87 | 1.13 |
| V9: Superior appreciates suggestion for improvements | 4.57 | 5.20 | -0.63 | 2.16 | 1.61 |
| V10: Bank is sympathetic to officers view | 3.26 | 5.05 | -1.79 | 1.96 | 1.65 |
| V11: Bank appreciates performance | 3.07 | 5.01 | -1.94 | 1.97 | 1.58 |
| V12: Prefer to work with present colleagues | 5.61 | 5.67 | -0.06 | 1.31 | 1.41 |
| V13: Bank's policy is to overdrive workers to get the maximum | 3.94 | 5.73 | -1.79 | 1.88 | 1.52 |
| V14: Satisfied with increment allocation method | 3.15 | 4.88 | -1.73 | 2.09 | 1.59 |
| V15: Superior gives reasonable attention to suggestions | 4.54 | 4.97 | -0.43 | 1.92 | 1.55 |
| V16: Bank treats officers worse than other banks | 3.31 | 3.60 | -0.29 | 1.59 | 2.19 |
| V17: Being able to do better than present work | 5.87 | 5.84 | +0.03 | 1.72 | 1.26 |
| V18: Income is higher than other Banks | 2.39 | 5.05 | -2.66 | 1.72 | 1.61 |
| V19: Satisfied with the chances of promotion | 2.07 | 5.01 | -2.94 | 1.70 | 1.83 |
| V20: Satisfied with Personnel development programs | 3.67 | 4.57 | -0.90 | 1.94 | 1.79 |
| V21: Very good relationship between union and management | 2.78 | 4.51 | -1.73 | 1.80 | 1.55 |
| V22: Would not leave job if similar position is affered by another organization | 3.80 | 3.99 | -0.19 | 2.26 | 2.07 |
| V23: Leave rules cover average requirements adequately | 4.89 | 5.53 | -0.64 | 1.91 | 1.53 |
| V24: Maximum facilities given for working properly | 3.96 | 4.99 | -1.03 | 1.92 | 1.41 |
| V25: Satisfied with the welfare facilities | 2.33 | 4.52 | -2.19 | 1.63 | 1.67 |
| V26: Satisfied with the chances of income increase | 2.41 | 4.96 | -2.55 | 1.56 | 1.54 |
| **Overall job satisfaction** | **3.70** | **5.64** | **-1.94** | **2.01** | **1.35** |

Standard deviation was used to see the attitudinal dispersion of the respondents. Considering a neutral value of 3.5 in the 7-point scale, 10 variables (mentioned in Table 5) in branches are found lower than the neutral value. It shows a relatively higher level of job dissatisfaction in branch employees. On the contrary, there is no value found lower than the neutral level in the branches, indicating relatively higher level of job satisfaction. The differences between virtual and branches have also been identified in job satisfaction variables. It shows negative differences in all the mean values between virtual and branch employees except ‘ability to do better than present work’ showing an insignificant positive difference (0.03). Among the negative differences, top five variables are: satisfied with the chances of promotion (-2.94), income is higher than other banks (-2.66), satisfied with the chances of income increase (-2.55), satisfied with present salary (-2.48), and satisfied with the welfare facilities (-2.19). The comparisons of all the mean values highlight a higher level of job satisfaction in branch employees than that of the virtual. The fact is supported by the differences between the overall job satisfaction in branch and virtual bank employees (3.70 versus 5.64). The reasons for this difference in job satisfaction between branch and virtual bank employees might mainly be related to the bank’s salary, efficiency in work, fringe benefit, supervision quality, and co-worker relations.

## CONCLUSIONS

This study shous that the overall job satisfaction of Turkish bank employees is at the positive level with an average overall job satisfaction value of 4.83. However, the job satisfaction of bank employees is significantly dependent upon salary, efficiency in work, fringe benefit, supervision quality, and co-worker relations. The remaining three factors, leadership style, loyalty to bank, and work ability do not have significant statistical evidence to improve the job satisfaction of bank employees. Working type is found to be the most relevant with the bank employees’ job satisfaction in comparison to work experience, age, and sex differences one. Branch employees are comparatively more satisfied than those from virtual as they enjoy better salary, better fringe benefits, quality supervision, good co-worker relation and yield higher efficiency in work. Virtual employees, on the other hand, have inadequate benefits and facilities, resulting in comparatively lower level of job satisfaction. It is also unders toad from this study that the work experience is the second important factor affecting job satisfaction of bank officers. Sex and age differences are found less important factors towards job satisfaction. The level of overall job satisfaction in branch employees is found much higher (5.64) than the one that leaves the same for virtual employees into a marginal level (3.70).

## REFERENCES


1-Aldrich, H. (1999). *Organizations evolving*. London: Sage Publications.

2-Applewhite, P. B. (1965). *Organizational behavior*. International Series in Industrial Engineering and Management Science. Engelwood Cliff, New Jersey. Prentice Hall.

3-Bhatti, K., & Qureshi, T. (2007). Impact of employee participation on job satisfaction, employee commitment and employee productivity. *International Review of Business Research Papers*, 3(2), 54 – 68.

4-Byers, R., Lederer, P.J. (2001), "Retail bank services strategy: a model of traditional, electronic, and mixed distribution choices", *Journal of Management Information Systems*, Vol. 18 No.2, pp.133-156

5-Cranny, C.J., Smith, P.C., & Stone, E.F. (1992). *Job satisfaction: How people feel about their jobs and how it affects their performance*. New York: Lexington

6-Gerson, V. (1998), "Service with more than a smile’", *Bank Marketing*, Vol. 30 No.8, pp.32-65

7-Kelley, T. (2005). Employee satisfaction results in improved profitability, retrieved April 4th, 2008 from http://www.indiangaming.com/istore/Nov05_Kelley.pdf.

8-Mols, N.P. (1999), "The Internet and the banks’ strategic distribution channel decisions", *International Journal of Bank Marketing*, Vol. 17 No.6, pp.245-300.

9-Moutinho, L., Phillips, P.A. (2002), "The impact of strategic planning on the competitiveness, performance and effectiveness of bank branches: a neural network analysis", *International Journal of Bank Marketing*, Vol. 20 No.3, pp.102-105

10-Moyes, G. D., Shao, L. P., & Newsome, M. (2008). Comparative Analysis Of Employee Job Satisfaction In The Accounting Profession. *Journal of Business & Economics Research*, 6(2), 65:81.

11-Mukherjee, A., Nath, P. (2003), "A model of trust in online relationship banking", *International Journal of Bank Marketing*, Vol. 21 No.1, pp.5-15.

12-Nancy B., Lockett, A., Winklhofer, H., and Christine, E., (2001), “The adoption of Internet financial services: a qualitative study”, *International Journal of Retail & Distribution Management,* Vol. 29, No. 8, pp. 390-398

13-Rexha, N., Philip, R., Kingshott, J. and Shang-Aw, A., S. (2003) “The impact of the relational plan on adoption of electronic banking”, *Journal of Services Marketing*, Vol. 17, No. 1, pp. 53-67

14-Smith, P. C., Kendal, L. M., and Hulin, C. L., (1969) “The Measurement of Satisfaction in Work and Retirement” in: Huang, H. J., (1999) Job Rotation from the Employees’ Point of View, *Research & Practice in Human Resource Management,* 7(1), 76.

15-Steffy, B. D., and Jones, J. W., (1990) “Differences between Full-Time and Part-Time Employees in Perceived Role Strain and Work Satisfaction”. Journal of Organizational Behavior, 11, 3210-329.

16-Wallace, C., Eagleson, G., & Waldersee, R. (2000). The Sacrificial HR Strategy in Call Centers. *International Journal of Service Industry Management*, 11(2), 174-185.

17- Weiss, D. J., Davis, R. V., England, G. W., and Lofquist, L. H., (1967) “Manual for the Minnesota Satisfaction Questionnaire” in: Huang, H. J., (1999) Job Rotation from the Employees’ Point of View, *Research & Practice in Human Resource Management,* 7(1), 76.

## Appendix 1 Communality Values of Job Satisfaction Variables

| Factors | Variables | Communalities |
|---|---|---|
| Salary | Satisfied with present salary, | 0.757 |
| | Bank is sympathetic to officers view, | 0.635 |
| | Bank appreciates performance, | 0.687 |
| | Satisfied with increment allocation method, | 0.612 |
| | Income is higher than other banks, | 0.715 |
| | Satisfied with the chances of promotion, | 0.601 |
| | Satisfied with the welfare facilities, | 0.688 |
| | Satisfied with the chances with the income increase. | 0.767 |
| Efficiency in work | Not loose job if work efficiently, | 0.644 |
| | Immediate supervisor is reasonable, | 0.435 |
| | Satisfied with recognition by colleagues, | 0.595 |
| | Superior encourages suggestions for improvements. | 0.687 |
| Fringe benefit | Superior gives reasonable attention to suggestions, | 0.659 |
| | Satisfied with personnel development programs, | 0.675 |
| | Leave rules cover average requirements adequately. | 0.616 |
| Supervision | Satisfied with work allotments, | 0.538 |
| | Satisfied with general supervision of departments, | 0.651 |
| | Maximum facilities given for working properly. | 0.395 |
| Leadership style | Bank's policy is to override workers to get the maximum, | 0.551 |
| | Bank treats officers worse than other banks. | 0.706 |
| Loyalty to bank | Very good relationship between union and management, | 0.592 |
| | Would not leave job if similar job offer to other organization. | 0.546 |
| Co-worker relation | Job gives chances to do things felt best, | 0.683 |
| | Prefer working with present colleagues. | 0.546 |
| Work ability | Fair chances given for better work, | 0.745 |
| | Able to do better than present work. | 0.775 |

# STRATEGIC HUMAN RESOURCE INFORMATION SYSTEMS

**Siamak Azadi**
**Iranian Academic Center For Education ,culture and Research (ACECR)**

## ABSTRACT

*All organizations need to keep records about their personnel, for instance, to comply with taxation requirements, for use in emergencies and as the basis for making decisions about the work their personnel perform. These organizations have a human resources function that handles the personnel's records. The ideal system that is used in managing the personnel is called the Human Resource Information System (HRIS).*

## INTRODUCTION

In the past, the personnel will do their paperwork manually (manual recording practices). However, as paperwork requirements grew, and the organisations needed more and more information about their employees, there is a need to use the computer-based management information system that getting data and information of the employees to be assessed. In this case, the state-of-art system was introduced and implemented to the organisations.

According to Raymond (1998), the status of personnel data was becoming more important due to the development of government laws and regulations through the Equal Employment Opportunity (EEO), Affirmative Action Program (AAP), and Occupational Health and Safety Administration (OHS). Because of these organisation needed to provide the reports showing that the personnel practices complied with the laws. Thus, there is a need to use the computer-based system to provide accurate information effectively and efficiently to the national government with statistics or data that are readable.

### *Definition of HRIS*

***A HRIS is the system used to acquire, store, mainpulate, analyse, retrieve, and distribute pertinent information regarding an organisation's human resources (Michael et al, 1990, p.29). It is an organisational tool for preparing relevant information for the users and managers to assist with their decision making about human resources of an organisation.***

***The HRIS includes people, format forms, policies and procedures, and data of the organisation. The prospect of the HRIS is to provide an easy access and service from a series of data to a readable and understandable information to the users. The information that is provided may facilitate any users especially the operational and managerial levels of the organisation to review the personnel's performance, and in any important decision making.***

***The effective use and benefits of HRIS to the users in obtaining the information will be very accurate, relevant, prompt, and available when needed for making any managerial decisions for the organisation in a short period of times.***

***It would suggest that the manager must ensure that the HRIS contributes to the attraction, development and motivation of human resources for the organisation. All managers in the organization need to make use of their organization's HRIS so as to provide a powerful competitive edge.***

## *Key Questions to Consider*

Goal-setting requiring activities may be valuable to managers in bringing out the best performance from HRM. It would suggest that, managers can use the following questions for this purpose so that he or she will know what are the first hand objectives for the human resource management:

- ***What is the information about employees to be used for?***
- ***What data about employees should be gathered and kept?***
- ***How can the data be manipulated to add maximum value?***
- ***Who needs access to information about the organisation's employees?***
- ***What is the continuing role of Human Resources Management (HRM) in relation to Human Resources Information System (HRIS)?***

## *Effect of HRIS on HRM*

***Use of HRIS information in decision making and reporting – it is important to note that different users will have different understanding of what the system is about and of its use to the organisation. It would suggest that the HRIS has been compared with a pyramid (Organisational Level of Management, refer table 1) which it showed that:***

- ***The base consists the transaction processing level, which related to the processing of basic personnel records.***
- ***The second level consists the management information areas where the most likely use is the generation of regular and ad hoc reports.***
- ***Corporate level of management relates to data that can be used for strategic planning and decision support.***

**Table 1: HRIS on Organisational Level of Management**

| | | |
|---|---|---|
| **Corporate Level of Management** | Management information for strategic planning, policy formulation and decision making | • Summary reporting<br>• Projections<br>• Manpower planning |
| **Second Level of Management** | Management information for tactical planning and decision making | • Summary reports and generation of ad hoc reports |
| **Third Level of Management** | Management information for day to day planning decision making and control | • Regular reports and generation of ad hoc reports |
| **Operational Level of Management** | Transaction processing and general inquiry facilities | • Basic system process like personnel records |

Information concerning an organisation's employees should be used for decision making in every area of employment. Most HRIS include some combination of the following activities:

- Equal employment opportunity affirmative action
- Health and safety
- Human resource planning
- Payroll (Wages and Salaries)
- Personal Details
- Performance Management
- Recruitment and employment
- Training and development

There are a large amount of software that are available and design specifically according to the needs of the particular department so as to support the HR function. Some of the software or information systems that are being used in an organisation that served and offered different usage in HRIS. We may discuss a few which are listed as below:

Employee information system: A set of human resources profile records that contains personal and organisation-related information, such as name, address, sex, year of services, education and training, previous experience, salary rate and other personal information. By using this employee information system will allow the manager to identify the percentage of employees who will be of retirement age as the recruit young personnel to fill the positions vacated by retirements.

Performance management information system: This system includes the performance appraisal data in terms of how the performance was measured and reported. Thus, this can lead to a number of decisions to retain, promote, transfer, or terminate a single employee. Moreover, this system can identify whether the staff has certain specialties or expertise in certain areas, if not, training program can be developed for the staff so as to improve their skills in a particular area.

Payroll information system: This is a system that recorded and concerned with staff pay rates, wage classifications, accuracy of tax calculations and other deductions and monitoring of compliance with company policies that concerning pay and benefits. In addition, the system needs to provide accurate data to the general of the firm.
The HRIS is a system that help the users to analyse the data necessary for them to make certain decision properly. However, the decision making still handled by people, not by system itself.

There are three steps (refer table 2) to generate the manual documentation into a readable and a presentable report for the managers. Managers are using that piece of information or reports to assist them in any way in decision making, especially to manage the human resources.

**Table2: HRIS's procedure**

| | |
|---|---|
| Step 1: Inputs | The system is a set of activities that allow the users to enter the employee's personal information into the system itself. Of course, the information that is entered to the computer is from the hand written document. |
| Step 2: Transformations | This input information that we have entered into the computer or the system will change into something more useful to the organisation. It takes less time consuming to produce the outcome. For instance, the payroll information system may transform the hours worked into a calculation of salary pay or other tax calculations. |
| Step 3: Outputs | The output for the employee in terms of the payroll system that we have used and entered the information may produce the paycheck to the employee. At this stage, the output must be available in a timely manner, accurate, and readable. |

Source: Adapted from Michael L.G. 1991.

## Employee Data on the HRIS

Just to collect and maintain the essential data on employees is a big task**.** To get into more complex things like analysing absenteeism rates and trends that requires significant thinking, effort, and information**.**

Consider the following list of information headings that are needed and gathered out of over 100 elements of data to be collected, stored, maintained, sorted, and analysed from the staff of the organisation:

- Personal details e.g. names, birth date, tax file no, and home address.
- Location of position in the organisation, especially for large organisation.
- Details of present job (job description and specification) e.g. title of the job.
- Salary and benefit s details.
- Education and professional qualifications.
- Formal training, including attendance at seminars.
- Skills inventory, including on the job training, personal interests and pre-employment skills.
- Job history in the organisation, e.g. previous job grades and periods of employment.
- Performance in the organisation, as assessed and commented upon by all pervious managers.
- Details of separation from the organisation, including reasons for the separation.
-

## Manipulating Data for Maximum Added Value

***If you accept that the primary objective of any HRIS is to obtain and process useful information so that manager can make appropriate decisions about each and every employee, then the maximum added value comes from:***

- Providing what the manager want – up-to-date information.
- Provide a complete picture of the problem and possible offer alternatives solutions.
- Information must be easy to understand and read.
- The information is better to consistent in format.

Appropriate decision is based on the manager's knowledge and assessment of the employee, supported by facts and evidence from experience and other sources, including the HRIS. Managers who know their staff well are most likely to make appropriate decision.
The following diagram (refer figure 1) provides an overview of the types of information from the

HRIS may assist with and link with other human resource systems.

**An idea HRIS links all key information about the person and job**

- **Career Planning**
- **Performance Management**
- **Development and Training**
- **Selection and Employment**
- **Government Return**
- **Human Resources Planning**
- **Job Profile**
- **Benefits**
- **Salary Management**
- **Payroll**
- **Personal Details**

**Figure 1 System that link with HRIS**

There are four typical competitive goals purse by the organisations in adopting the HRIS that relate to other organisation's functions. They are:

- The quality of the outcome (reports)
- The cost of the system
- Delivery of the analysis
- Flexibility to use the system

With the use of HRIS and human resources practices is examined in relation to the company's success in achieving competitiveness.

## 8. Access of Personnel Information

The HRIS is not an open system in any organisation, therefore, only for these people who need to maintain the data or need to view the information for decision making or reporting purpose should have the access of the personnel information.

According to Michael (1991), the HRIS must meet a number or basic requirements in terms of the access to the personal records of employees in an organisation. They are listed as below:

- It must be an on-line system.
- Users must property trained to sue HRIS
- System must include an effective report generator.
- Confidentiality of data must be safeguarded and the used of the password.
- Data within the system must be easily accessible. Essential keys fore retrieval are the personal number and employee name.
- Different manager at different management levels must have certain access of the information.
- Defining clearly and limiting user authorisation, verifying that person is the actual person who authorised to use the system.

There are a large number of people will be directly affect by the implementation of a HRIS, which is a state-of art system or technology that assist in anyway in human resources of an organisation. According to Michael et al (1990), people who involve in the implementation of HRIS are called stakeholders. This is because they have a stake in assisting the system to run effectively and efficiently.

Different people have different expectation of their outcomes by generating the HRIS. Their needs are different based on their department and job requirements. In this case, there will be conflict between the system designers and the other group of stakeholders in terms of needs and expectations. Figure 3 shows the different expectation from different group of stakeholders in regards to the use of HRIS in the company.

**Figure 2: Differing Expectation of Stakeholders**

| Stakeholders | Expectations |
|---|---|
| System Designer | Was the system challenging to design? |
| HR Users | Is the system easy to use?<br>Is the system well documented?<br>Does it provide timely information? |
| Managers | Does the system aid in managing?<br>Does it reduce administrative paperwork?<br>Are reports accurate and timely? |
| Employees | Will any personal information be kept private?<br>Will the system control me? |
| System Operations | Is the system easy to operate?<br>Is the system easy to maintain? |

***Source: Adapted from Michael et al. 1990, p. 189.***

Since the different group of stakeholders has different needs and expectations according to their job requirements. The training program for each of the stakeholders or user will be different. For instance, some users will need to be trained in report generation and others on the actual operation of the system. In other word, training needs will offer to different groups.

## 9. Continuing role of HRM in relation to HRIS

By using the state-of-art system in an organisation does not mean that the role of the human resource managers will decrease in importance whereas they shift to a greater emphasis on strategy and decision making (using the information to enhance quality of business decisions).

Following by the information that are generated and obtained from the HRIS will facilitate the human resource managers to involve themselves in the strategic planning process. The system will provide possibly alternatives for the solutions and may predict certain possibility that will occur in the future. Furthermore, HRIS will integrate the human resource information along with the information from other function (e.g. Marketing, Finance, IT, Operational etc), will produce a clearer picture of the overall functioning to the operating and managerial levels of the organisation.

The HRIS facilitate the human resource managers by providing the reports or information that are needed in a much easier and less time consuming manner. This will allow the human resource personnel to work closely with other. Moreover, the human resource personnel will move themselves toward the consulting role and the good governance, using their internal consulting skills and knowledge to assist the organisation in analysing the information with the help of HRIS.

The human resources department experiences the changes and restructuring of using the HRIS. This is because the relationship of human resources department to other groups will shift to decentralisation in the area of management. The use of HRIS will make information more readily available at all levels of the organisation. However, it improves the communication links and user interfaces within the organisation.

However, when the decentralisation is occurred, the centralisation focus is occurred and remained at some areas such as the Compensation Management, Payroll, Benefits Administration, and Government Reporting. The Reason behind this will be the government regulations in this particular area that make it unlikely to comply in decentalisation focus.

When the human resource practices meet the human resource information system (the new technology), there are a new roles for human resource management. The purpose of today's human resource management software packages is to present the network to the human resources so and to allow the organisation can deploy to cope with problems.

## 10. Conclusion

The details of this paper are guideed manager to summarise the overview elements of the HRM, and to demonstrate the consistency between the overall HRIS. The detail of this paper also consist of the explanation of how employee data located on the HRIS, manipulating data for maximum added value, who need to maintain and view the data, and continuing role of HRM in relation to HRIS.

Overall, HRM and HRIS requires personal discipline, commitment, and sacrifice. Successful implementation hinges upon human resource managers' ability to maintain performance and change, which are necessarily more extensive when information system to be implemented rather than the past in order to meet the good governance.

## REFERENCES

Michael L. Gallagher, 1991, Computer and Human Resource Management, 2nd edition, Butterworth Heinemann, UK.

Michael J. Kavanagh, Hal G Gueutal, and Scott I. Tannenbaum, 1990, Human Resource Information System: Development & Application, PWS_KENT, USA.

Raymond McLeod, Jr., 1998, Management Information Systems, 7th edition, Prentice Hall, USA.

# EMOTIONAL HUMAN RESOURCE MANAGAMENT


## Tanju Colakoglu
## Canakkale Onsekiz Mart University, Turkey


## ABSTRACT


*The main object of this paper is to point out a specific need of human resources policies to gain one more step in competition. Recent studies show that managing human communities requiring emotional intelligence more than intelligence quotient. It's a fact that emotional intelligence level is big factor determining human relations. But the need of specifying "which sectors of business needs more emotional intensity and which dimensions are required weightily for different areas of business" is still uncovered. Once the emotional expectation of the human resources is determined than it would be easy to obtain qualifications by obtaining new members or educating the existing ones. By the perception of satisfied emotional expectations, reflection would be high level of efficiency.*



***Keywords:*** *Emotional Labor and Intelligence, Emotional Perception and Expectation, Emotion Management, Human Resource Management Policies, Leadership and Strategic Management,*


## INTRODUCTION

Contemporary business world is changing rules of the game and evolving its new literature. The importance of the concepts and values changing too fast to fallow for most of entrepreneurs and those are becoming competitively disadvantaged in long terms. The sustainable competence depends on ability of adaptation to change that consists of associations' human resources' abilities. In order to manage the change, management needs to have an effective communication with human resources. This is the point where we face with "emotional human resource management" as a solution.

Knowing that emotional intelligence is more effective than intelligence quotient in all kinds of human relations including management, recent studies focus on sub dimensions of emotional intelligence. These studies are result of difference of emotional needs at business life. Every firm has its unique conditions forming differentiated emotional expectations. As an emotional human resource manager or a charged emotional labor (probably an experienced or specialized subordinate) the emotional intelligence manager needs to know required emotional intelligence qualifications in order to satisfy them. A satisfaction perception of emotional expectations mostly boosts personal efficiency as a "win win" strategy. The perception of emotionally caring management empowers the corporate citizenship culture.

As mentioned above success at a subjective area like emotional satisfaction usually is hard to reach since it requires detailed human resources expectations data and specialization on these fields. That's the reason (high costs and failure probability) most management staff prefers staying out of subject. Its hard take action at that field while there is no agreement about dimensions of emotional intelligence at literature. Even it's questioned that placing these actions under emotional intelligence field or social intelligence field or corporate intelligence field etc.

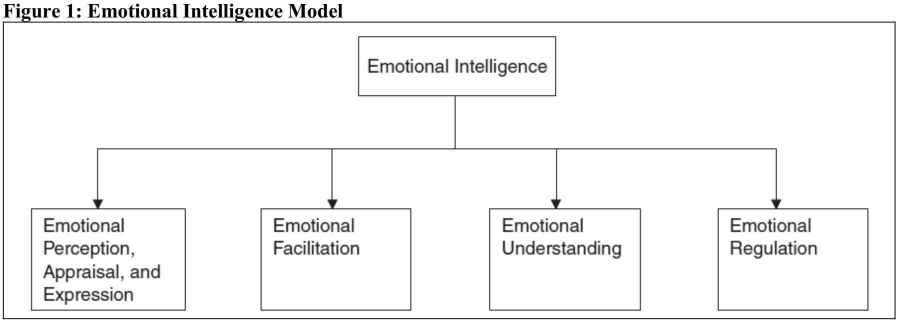
This study begins with assumption that emotional intelligence has the key role in understanding and satisfying the emotional expectations of the human resources. Study intends to mention the need of further research about emotional management and especially implementations of emotional intelligence dimensions by specifying both expectations and solutions. Specialization on these dimensions would be certainly helpful about defining which emotional dimensions are more necessary for sustainability and how to maintain them (or at least providing a perception that they are seem to be maintained). Study will also shape writers further studies on "emotional expectation survey" that is being modifying from several emotional intelligence surveys. With the success about proving reliability of these surveys implementations, the interest of both business and academic world thought to be increasing. Further research maintained by increasing mention would cause the fastened improvement. On the other hand business world would support such research as long as the field has implementations that have a probability of maintaining benefit in work life.

# LITERATURE REVIEW

## Emotional Intelligence

Emotional intelligence subject mostly owe the contemporary interest to Daniel Goleman’s first book that has the “emotional intelligence” concept at topic. According to a popularized definition made by Goleman emotional intelligence is the capacity about organizing self and others feelings for motivation, managing self emotions wisely and also in relationships (Goleman, 1998: 317). Its said to be that Publilius Syrus stated “rule your feelings otherwise your feelings rule you” in first century B.C.(Salovey, Mayer, 1990: 185). EI is “the ability to monitor one’s own and others’ emotions, to discriminate among them, and to use the information to guide one’s thinking and actions” (Zeidner and others, 2004: 373). Investigated correlations between social desirability and several characteristics including emotional intelligence, it’s found that emotional intelligence corporate with self esteem is potentially valuable predictor of socially desirability (Magnus and others, 2006: 353).

**Figure 1: Emotional Intelligence Model**

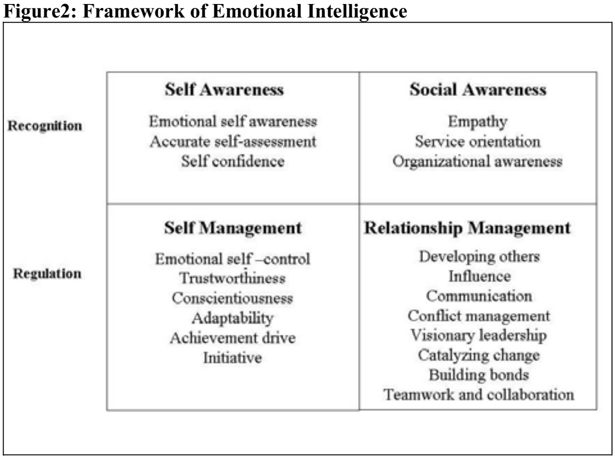



Source: Prati and others , 2009: 4

## Dimensions of Emotional Intelligence

Different types of human community’s show different types emotional intelligence characteristics. Due to a study focused over computing students shows that there is a significant difference between computing students and noncomputing students on emotional intelligence. So it’s offered for computing students to better target their needs and increase retention in computing programs and enhances job performance (Bélanger an others, 2007:194-195).

**Figure2: Framework of Emotional Intelligence**




Source: Barry and Plessis, 2007: 1

The emotional intelligence components are: (a) perception/appraisal/expression of emotion (Emotional Perception or PEIQ), (b) facilitating emotion in thought (Emotional Integration or FEIQ), (c) understanding emotion (Emotional Understanding or UEIQ), and (d) regulating emotion (Emotional Management or MEIQ). Emotional Intelligence may be applied by: Idealized Influence/Charisma (II), Inspirational Motivation (IM), Intellectual Stimulation (IS), Intellectual Stimulation (IS), Individualized Consideration (IC) (Petran, 2008: 53-60).

## Effects of Emotional Intelligence

Empirical study made by Rahim and Minors shows that organizations are looking for an employee improvement about quality of products and services must apply trainings about emotional intelligence (Rahim and Minors, 2003: 152- 154). More over according to most of the studies individuals having high levels of emotional intelligence tend to be more satisfied with their lives and able to percept pleasure from wider range of effects (Furnham, Christoforou, 2007: 460). On the other hand while emotional intelligence is accepted as a desired qualification, it's not so easy to be developed. A study comparing Brazilian and American managers and consultants participated in a Mastering Emotional Intelligence (MEI) workshop shows that insufficiently motivated ones show little progress at the end (Sala, 1-6). Daniel Goleman's analysis of 181 jobs in 121 organizations showed that emotional capabilities are best determiners of performance (Dattner, 11).

According to a study the facts about the impact of emotional intelligence are: The insurance sales agents having less emotional abilities sold policies at an average of $54000 while emotionally advantaged ones sold policies at an average of $114000 (Watkin, 2000: 91). EIC (emotional intelligence competency) defined as "an underlying characteristic of an individual which is causally related to effective or superior (one standard deviation above the mean) performance in a job". An example of evaluating outcomes (economic value) of EIC-based human resource programs to individuals or organizations shows the significant difference at table (Spencer, 2001:1-3).

**Table1: Treatment Group versus Control Group Performance Over One Year after Training**

| | Revenue | Operating Income | Profit |
|---|---|---|---|
| Trained group *(N=23)* | $3.117M | 0.3% | $249,000 |
| Control group *(N = 7)* | $1.660M | 0.7% | $192,000 |
| Difference | $1.457M | - 0.4% | $ 57,000 |
| *p (t- test)* | *< .04* | *n.s.* | *< .02* |

• Es shift from training: $57K/$456K ~.125
• Investment: $8,000/BM trained x 28 BMs trained = $224K
• Return: +$57K Profit/BM trained x 28 BMs trained = $1,596K additional profit
• ROI = 613 percent
Source: Spencer, 2001: 28

Emotional intelligence is a key capability in management, especially in communication. According to Joyce Cochner, one of the managers of Allstate Insurance, "If you want to stay at beginning level at a job you don't need to write well. On the other hand if you want promotion writing becomes vital. If you want to be a top manager you need to be able to speak in front of people and write a little bit" (Locker 1992: 6).

## Emotional Management

According to Goleman "a person may have the best training addition to incisive, analytical mind and an endless supply of smart ideas but he still wont become a great leader without emotional intelligence" (Goleman, 1998: 108). Since the role of leaders is creating environments that will allow staff to success in work life, leaders need emotional intelligence for building, developing and managing relationships (Peters, 2008: 13). As a result of corporate citizen behavior the question of "who are you" mostly perceived as "organization membership" by US Marines. Similarly it's seen that emotionally intelligent managers easily organize subordinates perception of accepted organization culture by using relations (Prati and others, 2009: 2-4). Top leadership position selection shows that emotional intelligence indicates the performance by %85.

At the organizations the divisions whose senior managers have more emotional intelligence performed an advantage of %20 annual earnings (Watkin, 2000: 91).

According to another empirical study's findings employees' willingness to act entrepreneurially at work is lower when managers display high levels of emotions like frustration, worry, and bewilderment, respectively and that is significant sign that the staff at management level need to manage their own emotions as well (Brundin and others, 2008:237). Perception of organizational justice and fair usually related with emotional and intellectual recognition. The hypothesis may supported by interviews with participants from different organizations. While the staff of the organization that has managers does not provide the adequate recognition declares suffering, the staff of the organization that has managers provides the adequate recognition face with positive feelings. Top managers behaviors are seem to be the indicative (e Cunha and others, 2009: 89). Emotional perception abilities empower the leader to establish and maintain supportive relationships with social environment (Petran, 2008: 50). Impression management also known as "self expressing" is an emotional management implementation that works for both managers and managed ones. Especially employees may be motivated to manage perceptions of their managers in order to get promotion or extras (Luthans 1995: 105). Impression management defined by Wayne and Linden as using both or one of "protection of self image by individuals", "influencing the perception of individuals by others" (Xin 2004: 160).

## METHODS

Study using literature comparison since application process is still at progress. Samples having quantitative data given to realize theoretical frame. The application "Emotional expectation survey" will give additional support and implementation area. The results of applications planned to conclude till the presentation. The results and data set will be shared at presentation so that reviews of participants would collect and evaluated.

The application plan is consist of double layered survey. First step is applying emotional intelligence survey to management side (in this study to lecturers in faculty since my selected universe is a faculty). Second step is applying emotional expectation survey to managed side (in this study to students). Baron Emotional Score Inventory is selected as emotional intelligence survey since this survey applied by many researchers and proved by many studies. Questions of emotional expectation survey are adapted from Baron Emotional Score Inventory and origin of survey scale is SERVQUAL (Perceived Service Quality) survey. This adaptation lets the researcher to maintain correlations between two surveys. Both surveys are using 5 leveled scale that maintains comparable results. Some of the hypotheses are:

- high EQ level correlates with strategic management issues such as formal and informal communication with ordinates, staff, retailers and consumers;
- high EQ leveled staff increases motivation of whole organization; creating and empowering values of organization such as organizational culture, organizational citizenship behavior etc.;
- high EQ brings positive perceptions by others
- and resultantly of all mentioned and unmentioned benefits, high EQ (on necessary EQ dimensions) provides success in work life.

Dividing emotional intelligence to five dimensions, we had five questions for each dimension that totals 25 questions in both surveys. The original Baron Emotional Score Inventory (88 questions) is shortened and simplified in order to supply more fulfilled surveys.

The results of surveys expected to give confirmation to hypothesis. Otherwise hypothesis will be revised. Additional purpose of the study, determining the importance of each emotional intelligence dimension, would be lightened as well.

## CONCLUSION

Emotional intelligence growingly becoming a popular study field for both academic and business world in these days. New application areas are developing every day. A need of emotional intelligence development is granted by all participants. Differentiated emotional intelligence programs are developing currently. The "simply developing the skills of emotional intelligence may not prove fruitful unless we also implement interventions that address the contextual and motivational factors affecting the use of these skills" fragment explains the situation clearly (Salovey and Grewal, 2005: 85).

At this point the selection of emotional intelligence development program becomes vital for companies. There are lots of choices but how to select the most fitting choice still questionable. Our study shows that even different departments of a company needs different emotional intelligence development program due to the different needs of emotional intelligence dimensions. The emotional intelligence requirement of selected society must be defined fully in order to "give the right pill". Our proposal is specifying the weights of emotional intelligence dimensions required for selected fields would gave a possibility of choosing the rational education or staff.

Further research in different universe clusters will uncover the different weighted emotional intelligence dimension needs. Only after these further studies in different social clusters (different organizations, departments, sectors etc.), a scale that reveals necessary emotional intelligence dimensions for each target group may be constituted. This scales will gave a brief idea about which qualifications are needed at specified field, how to obtain them and how to develop them. By this way waste and corruption of time, money and opportunities would decrease to minimum as well. This system supplies vital information to requiring management levels for taking proactive decisions instead the reactive ones.

# REFERENCES

1-Goleman Daniel, "Working with Emotional Intelligence" 1998; Translated as "İşbaşında Duygusal Zeka", 3rd edition, Varlık Yayınları, Istanbul, 2000.
2-Rahim M. Afzalur, Minors Patricia, "Effects of emotional intelligence on concern for quality and problem solving", Managerial Auditing Journal, 18/2, 150-155, 2003.
3-Salovey Peter, Mayer John D., "Emotional Intelligence", Baywood Publishing Co., Inc., 1990.
4 Peters Donn, "What is emotional intelligence", Enterprise/ Salt Lake City, Jan. 28- Feb. 3, 2008.
5-Furnham Adrian, Christoforou Irene, "Personality Traits, Emotional Intelligence, and Multiple Happiness", North American Journal of Psychology, Vol.9, No.3, 439-462, 2007.
6-Brundin Ethel, Patzelt Holger, Shepherd Dean A., Managers' emotional displays and employees' willingness to act entrepreneurially, Journal of Business Venturing, 23, 221-243, 2008.
7-Barry Marie-Louise, Plessis Yvonne du, "Emotional intelligence: a crucial human resource management ability for engineering project managers in the 21st century", IEEE, 1-4244-0987-X/07, 2007.
8-Bélanger France, Lewis Tracy, Kasper George M., Smith Wanda j., Harrington K. Vernard, "Are Computing Students Different? An Analysis of Coping Strategies and Emotional Intelligence", IEEE Transactions on Education, Vol. 50, No. 3, August 2007.
9-Sala Fabio, "Do Programs Designed To Increase Emotional Intelligence At Work- Work?", Emotional Intelligence Program Eval, http://www.eiconsortium.org/pdf/mastering_emotional_intelligence_program_eval.pdf
10- Spencer Lyle M., In Cherniss, C. and D. Goleman, eds. The Emotionally Intelligent Workplace, Chapter Four: The Economıc Value Of Emotıonal Intellıgence Competencıes And Eıc-Based Hr Programs, 2001.
11- e Cunha Miguel Pina, e Cunha Rita Campos and Rego Arménio, Exploring the Role of Leader_Subordinate Interactions in the Construction of Organizational Positivity, Leadership; 5; 81- 101, DOI: 10.1177/1742715008098311, 2009.
12- Prati L. Melita, Capehart Amy McMillan, Karriker Joy H., Affecting Organizational Identity: A Manager's Influence, Journal of Leadership& Organizational Studies, February 5, 2009.
13- Dattner Ben, Succeeding with Emotional Intelligence, http://www.dattnerconsulting.com/presentations/ei.pdf
14- Watkin Chris, Developing Emotional Intelligence, International Journal of Selection and Assessment, Vol:8, No:2, June 2000.
15- Salovey Peter, Grewal Daisy, The Science of Emotional Intelligence, Current Directions in Psychological Science, Volume 14—Number 6, 2005.
16- Zeidner Moshe, Matthews Gerald, Roberts Richard D., Emotional Intelligence in the Workplace: A Critical Review, Applied Psychology: An International Review, *53* (3), 371–399, 2004.
17- Magnus and others, Social Desirability: The Role of Over-Claiming, Self-Esteem, and Emotional Intelligence, Psychology Science, Volume 48 (3), p. 336-356, 2006.
18- Petran Michael Paul, An Exploratory Study Of Executive Transformational Leadership, Wisdom, and Emotional Intelligence in Management Process Turnaround Situations, Dissertation for the degree of Doctor of Education, 2008.
19- Locker Kitty O., Business and Administrative Communication, 2nd Edition, Richard D. Irwin Inc., Boston, 1992.

20- Luthans Fred, Organizational Behavior, with the permission of Seventh Edition, McGraw- Hill Literatur Publication, Istanbul, 1995.
21- Xin Katherine R., "Asian American Managers: An Impression Gap? An investigation of impression management and supervisor- subordinate relationships" The Journal of Applied Behavioral Science, Vol. 40, No. 2, June 2004.

# THE MODERATING ROLE OF FORMALIZATION IN DETERMINING THE EFFECTS OF STRATEGIC FLEXIBILITY AND PERCEIVED RISK ON AFFECTIVE ORGANIZATIONAL COMMITMENT

**Mehmet Şerif Şimşek**
**Selcuk University**

**Şevki Özgener**
**Metin Kaplan**
**Aslı Kaplan**
**Nevsehir University**

**Gökşen Topuz**
**Selcuk University**

## ABSTRACT

The purpose of this study is to investigate the moderating role of formalization in determining the effects of strategic flexibility and perceived risk on affective organizational commitment in tourism industry. The findings of the research indicated that strategic flexibility and perceived risk were found to be positively related to affective commitment for the senior executives and middle managers. Moreover, the participants suggested that the interaction of perceived risk and formalization had a negative effect on affective commitment. Formalization moderated only the relationship between perceived risk and affective commitment. Finally, practical implications are discussed, and suggestions for the future research are made.

**Key words:** Strategic Flexibility, Perceived Risk, Affective Commitment, and Hotel Businesses

## INTRODUCTION

Tourism, now a universal practice, is flourishing rapidly to become one of the leading industries in the world today. Based on the intense competition and globalization in the sector, value creating, speed, quality and cost have become the fundamental dimensions of the sustainable competition especially in terms of the hotel businesses. Therefore, the hotel managers focus on formalization and strategic flexibility. To be obtained benefits anticipated from strategic flexibility and formalization depends on managers' risk perceptions and hotel employees' affective commitment to organization. Undoubtedly, it is known that managers encounter some difficulties to solve problems in this respect. In order to overcome the mentioned difficulties, the number of the guiding researches that analyze the relationships between strategic flexibility, perceived risk, formalization and affective commitment is also relatively limited**.** Thus, this study will investigate the moderating role of formalization in determining the effects of strategic flexibility and perceived risk on affective organizational commitment in hotel businesses.

## Strategic Flexibility

In strategic management literature, strategic flexibility is a critical organizational competency in creating continuously customer value and generating competitive advantage leading to success and survival in the 21st Century. Flexibility, as a competitive priority, is possible thanks to volatile markets, shorter life cycles, affective commitment, strategic leadership, core competences, new technologies, formalization, flexible structures and culture (Hitt et al., 1998: 39; Gomez-Gras and Verdu-Jover, 2005: 842).

Strategic flexibility refers to the ability to precipitate intentional changes and adapt to environmental changes through continuous changes in current strategic actions, asset deployment, and investment strategies (Nadkarni and Narayanan, 2007: 245).

Strategic flexibility helps firms manage risks better by responding in a proactive or reactive manner quickly (Celuch et al., 2007: 190). Flexible firms exhibit both diversity in strategic responses and rapid shifts from one strategy to another (Nadkarni and Narayanan, 2007: 245). In this context, small firms, relative to larger firms, are more likely to achieve strategic flexibility as a result of entrepreneurial alertness and faster response and implementation times (Celuch et al., 2007: 190). Strategic flexibility depends both upon a firm's resource flexibility and on the firm's ability to flexibly apply those resources to alternative courses of action when necessary. This allows the firm to have strategic options when dealing with dynamic environments (Lin and Chen, 2009: 826). While strategic flexibility may entail a number of organizational capabilities and resources, two organizational capabilities (product flexibility and cross-functional coordination) are most crucial to a firm's ability to pursue a variety of strategic options in response to the demands of changing markets (Zhang, 2005: 166). Furthermore, strategic flexibility is built on the planned emergence perspective, as managers incorporate different mechanisms in their strategic planning processes, routines, or norms to adapt or change the formalized strategic plan to more adequately reflect the needs required to compete in global markets (Dibrell et al., 2007: 28-29). In hotel businesses, the strategic flexibility is substantially crucial in terms of cross-functions collaboration, unconditional customer satisfaction, speed, and service quality. In the sector, the businesses particularly need the strategic flexibility thanks to entrepreneurial alertness, quick response and effective resource utilization.

## Perceived Risk

Perceived risk in the study is a one's anticipation of adverse consequences and feelings of uncertainty regarding the services provided by the organization (Johnson et al., 2008: 355). Perceived risk, therefore, is a function of the unexpected results of adoption and an outcome that deviates from expectation. Perceived risk may negatively influence the decision to adopt new products (Hirunyawipada and Paswan, 2006: 186). Perceived risk is also seen to stem from a number of commonly identified elements–product, purchase situation, people, culture, financial, performance, time or physical, social, and psychological risks (Mitchell, 1999: 167). Managers are more concerned about negative outcomes (losses) rather than positive outcomes (gains), and often tend to define risk only in terms of negative outcomes (Forlani et al., 2008: 294).

Previous studies have shown that the greater the perceived risk, the greater the number and types of information sources consulted by managers (Yeoh, 2005, 181). Managerial risk perceptions play a more vital role in managers' ultimate decisions than purely normative or otherwise objective risk assessments. When the managerial perceived risk literature is viewed, the most significant findings are classified in three groups (Forlani et al., 2008: 295):

(1) managers tend to define risk in terms of the amount of money that could be lost;
(2) managers tend to believe that risk can be controlled through managerial ability and talent; and
(3) managers will revise objective risk assessment reports until the estimates match their preconceived perceptions.

## Formalization

Formalization is the degree to which decisions and working relationships are governed by formal rules, standard policies and procedures (Daugherty et al., 1992: 50). Formalization is a core dimension of organizational structure. Formalization provides a shared language that facilitates communication and control social actors' behavior and outputs (Bodewes, 2002: 215-221). Formalization is comprised of both codification and observation. Codification is the placement of rules, procedures, and regulations in writing. Observation is the degree that employees are informed of the codification, and the degree that they are expected to follow the rules and regulations (Lambert et al., 2006: 28).

Formalization may allow individuals to make more objective decisions about whether to internalize the organization's goals as their own (Michaels et al. 1996:11). It also features in related fields such as technology management, strategic flexibility, organizational behavior and organizational communication (Bodewes, 2002: 215).

Formalization is believed to enhance performance by eliminating ambiguity, reducing risk, developing rules and procedures to routinize repetitive activities and transactions, and clarify priorities (Daugherty et al., 1992: 50). The objective of formalization is to prescribe what is to be done rather than how it is done (Daugherty et al., 1992: 51). While empirical investigations into the nature of formalization support the contention that formalized organizations tend to clarify priorities and avoid ambiguity, there is also an indication that formalized organizations tend to be less innovative and adaptive than organizations less formally organized (Daugherty et al., 1992: 51). By taking into account the short crisis period that often takes place in the global market, rapid technological changes, and rapid changes in customers' preferences, this study will investigate whether or not formalization play the role of moderator in terms of the effects of strategic flexibility and perceived risk on affective organizational commitment in hotel businesses.

# Affective Commitment

In recent years in the tourism sector as in many industries restructuring, outsourcing, delayering and rightsizing have been considerably prevalent. This trend causes great concern related to the nature of the job security within the context of the employment and psychological contract. Undoubtedly, employees who feel affective commitment to their organizations are more likely to overcome the turbulent processes.

Affective commitment refers to the employee's emotional attachment to, identification with, and involvement in the organization (Allen and Meyer, 1990). Affective commitment is the extent to which employees are involved with and have attached emotionally to their organizations because they identify with the goals and values of their organizations (Addae et al., 2008: 569).

Individuals with a high level of affective commitment continue to work for an organization because they want to (Aube´ et al., 2007: 481). Affective commitment is considered to be the product of an exchange between employee and organization, whereby individuals bring skills to the workplace, expecting to find an environment in which their abilities can be productively used and their basic needs can be met (Abraham, 2000: 275).

Affective commitment has positive effects on employees' organizational behaviors, for instance, intention to quit, turnover and job performance (Luchak and Gellatly, 2007; Vandenberghe et al., 2007). In addition, keeping the qualified employees in the businesses, benefiting from the advantages of tacit knowledge and responding to changing customer needs at once in the global competition is vital for the hotel businesses. Strategic leadership, flexibility structures, high performance teams, participatory management, organizational support, alternative work arrangements and empowerment have a crucial role in increasing affective commitment of employees in these businesses

In this context, the research objective of this study is to investigate the moderating role of formalization in determining the effects of strategic flexibility and perceived risk on affective organizational commitment in tourism industry.

There have been few studies which have demonstrated the relationships between formalization, strategic flexibility, perceived risk and affective commitment. Roca-Puig et al. (2005) examined the fit between employees' commitment to organization and strategic flexibility. They suggested that the greater the degree of strategic flexibility, the greater the positive effect of organizational commitment on performance. Morris and Steers (1980) analyzed structural influences on organizational commitment. The results showed that formalization was positively associated with organizational commitment. On the other hand, Bowen and Chen (2001) investigated the relationship between customer loyalty and customer satisfaction in hotels. According to the results, positive word-of-mouth decreased customer's perceived risk in hotels. Finally, Johnson et al. (2008) discussed the relationship between customer satisfaction, perceived risk and affective commitment. The findings of the research showed that there was no indication of current perceptions of risk having a detracting effect on commitment. In the light of these findings, the research model has been designed as following:

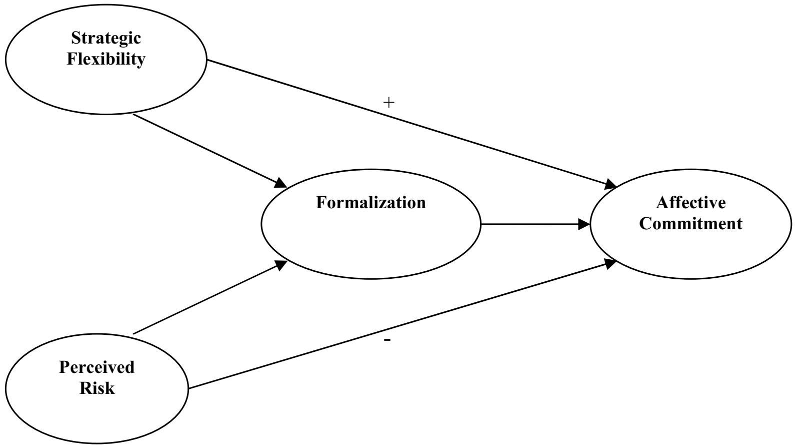



**Figure 1: Research Model**

The hypotheses developed in this context of the model are as follows:

**H1:** Strategic flexibility positively influences affective commitment.
**H2:** Perceived risk negatively influences affective commitment.
**H3:** Formalization will moderate the relationship between strategic flexibility and affective commitment.
**H4:** Formalization will moderate the relationship between perceived risk and affective commitment.

## METHODOLOGY

The sampling consists of senior executives and middle managers in hotel businesses licensed by the Tourism Ministry in the Cappadocia Region, Turkey. 24 hotels (five-star, four-star, three-star) take place in the region of Cappadocia. Nearly 110 senior executives and middle managers are estimated to serve in these hotels. More than one executive in the same hotel responded to the questionnaire in this study. Interviewers were used to distribute questionnaires to hotel businesses. 110 questionnaires were distributed. 77 questionnaires were returned. This represented an overall response rate of 70%. Affective commitment was designated as the dependent variable in this study while strategic flexibility and perceived risk were considered as the independent variables. Existing scales were adopted to measure all three constructs. Moreover, formalization as a moderator variable was used in the relationships between dependent and independent variables. *Strategic flexibility* is measured with six-item Likert scale ranging from 1 “not at all flexible” to 5 “very flexible”, taken from the work of Barringer and Bluedorn (1999). The instrument had reliability (Cronbach’s alpha) of 0.91. Usually, a value of 0.70 in the Cronbach’s alpha is considered adequate in order to ensure reliability of the internal consistency of a scale (Nunnally, 1978). To measure *perceived risk,* we used the six items perceived risk scale adopted by Sweeney et al. (1999) and Forlani, et al. (2008). Participants responded on a 5-point Likert-type scale dictating to the extent which they agree with each statement as it reflected their present work environment (1= strongly disagree, 5= strongly agree). The scale showed adequate reliability. The Cronbach’s alpha coefficient was 0.85. On the other hand, to measure *formalization,* we used six items scale adopted from Oldham and Hackman (1981) and Finlay et al. (1995). The six items were answered by a five-point Likert-type response scale ranging from strongly disagree to strongly agree. The instrument had reliability (Cronbach’s alpha) of 0.86. In this study, *Affective commitment* was measured using eight-item scale developed by Allen and Meyer (1990). Each item was linked to a five-point Likert response scale ranging from “strongly disagree” (1) to “strongly agree” (5). This scale is reliable (0.85)

## THE RESULTS

The demographic profiles of senior executives and middle managers are shown in Table 1. 16.9% of participants that responded to the questionnaire were female and 83.1% were male. In terms of education levels, 58.4% of participants had graduated from secondary school and 16.9% from high school. 23.4 percent of the participants had a bachelor's degree and 1.3% had a master's degree or higher. Participants held a variety of positions in hotels. They included Senior Executives (41.6%), Director (18.1%), Division Manager (13.0%) and Owners (27.3%). 49.4% of those responding had more than 5 years of managerial experience. 54.6% of the participants' age ranged from 26 to 40.

## Table 1: Demographic Characteristics of Sample

| Characteristics | | %) | Characteristics | | %) |
|---|---|---|---|---|---|
| ***Size of business (number of employee)*** | | | ***Managerial experience (number of years)*** | | |
| 1 to 25 | | | 0-5 | | |
| 26 to 50 | | 3.9 | 6-10 | 9 | 0.6 |
| 51 to 75 | 2 | | 11-15 | | |
| 76 to 100 | | 4.5 | More than 15 | 8 | 3.4 |
| 100 or more | 5 | | | | |
| | | 2.5 | **Gender** | 6 | 0.8 |
| **Hotel age** | | | Female | | |
| 0-5 | | 1.3 | Male | | 5.2 |
| 6-10 | | | | | |
| 11-15 | | 7.8 | **Age** | | |
| 16 or more | 3 | | Less than 25 | 3 | |
| | | | 26-30 | | 6.9 |
| **Hotel Category** | 0 | | 31-40 | 4 | |
| Five-star | | 9.91 | 40 or more | | 3.1 |
| Four-star | 7 | 3.0 | | | |
| Three-star | | | **Education Level of Participants** | | |
| | 7 | 2.1 | | | |
| **Organizational title/rank** | | | Secondary school | 8 | 7.8 |
| Senior Executives | | 5.0 | High school | | |
| Director | | | Bachelor' degree | 4 | 3.4 |
| Division Manager | 0 | | Master's degree or PhD | | |
| Owners | | | | 9 | 1.2 |
| | 3 | 6.0 | **Status of a person** | | |
| | | | Married | | 7.6 |
| | 4 | 2.9 | Single | | |
| | | | | 5 | |
| | | 1.1 | | | |
| | | | | 3 | 8.4 |
| | 2 | | | | |
| | | | | 8 | 6.9 |
| | 4 | 1,6 | | | |
| | | | | | 3.4 |
| | 0 | 8.1 | | | |
| | | | | | 1.3 |
| | 1 | 3.0 | | 3 | |
| | | 7.3 | | 4 | |
| | | | | | 8.8 |
| | | | | | 1.2 |

N=77

Table 2 presents descriptive statistics and correlations of the study variables. According to senior executives or middle managers, strategic flexibility was found to be positively related to affective commitment at the 0.05 level. Thus, the results supported H1. Perceived risk ($r=0,315$; $p<0.01$) and formalization ($r=0,326$; $p<0.01$) were also found to be positively related to affective commitment. Namely, H2 was not supported.

## Table 2: Descriptive Statistics and Inter-correlations among Study Variables

| Variable | Mean | Std. Dev. | 1 | 2 | 3 | 4 |
|---|---|---|---|---|---|---|
| **1. Strategic Flexibility** | 3,43 | 1,08 | ( 0.91) | | | |
| **2. Perceived Risk** | 3,29 | 0,91 | ,071 | (0.85) | | |
| **3. Formalization** | 3,18 | 1,02 | ,312(**) | ,198 | (0.86) | |
| **4. Affective Commitment** | 3,38 | 0,82 | ,246(*) | ,315(**) | ,326(**) | ( 0.85) |

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

Regression analysis was used to test the moderating role of formalization in determining the effects of strategic flexibility and perceived risk on affective organizational commitment for senior executives and middle managers. The variance inflation factors (VIFs) associated with each regression coefficient (ranging from 1.041 to 1.429) was all smaller than the suggested threshold of ten indicating that multi-collinearity is not a problem. Furthermore, correlations between variables ranged from 0.326 to 0.071 and were significant at a minimum level of 0.01. Given that none of the bivariate correlations was greater than 0.80, we can assume that multi-collinearity is not a problem in data. Moreover, unstandardized regression coefficients to analyze and interpret the effect of an independent variable on a dependent variable were used in this study (Akdogan et al., 2008: 244). Cohen and Cohen (1983) strongly suggested the use of unstandardized regression coefficients if there is no theoretical or empirical background to use standardized ones.

Using the hierarchical regression analysis, this study analyzed the moderating role of formalization in determining the effects of strategic flexibility and perceived risk on affective organizational commitment of senior executives and middle managers.

Table 3 present the results of the effect of formalization on the relationships between independent variables (strategic flexibility, perceived risk) and affective commitment. The baseline Model 1 contains control variables. Model 2 introduces strategic flexibility, perceived risk and formalization, and Model 3 includes the interaction effects on affective commitment.

**Table 3: The Results of Hierarchical Regression Analyses: The Effects of Strategic Flexibility and Perceived Risk On Affective Commitment**

| Independent variables entered | β | S.E. | t-value | $R^2$ | $R^2$ Change |
|---|---|---|---|---|---|
| *Model 1 F(4-72)= 1,589* | | | | 0.081 | |
| Gender | ,374 | ,252 | 1,487 | | |
| Age | ,147 | ,078 | 1,883 | | |
| Education | -,018 | ,107 | -,166 | | |
| Managerial experience | -,098 | ,111 | -,883 | | |
| *Model 2 F(7-69)= 3,140* | | | | 0.242 | 0.160 |
| Gender | ,269 | ,235 | 1,144 | | |
| Age | ,118 | ,077 | 1,534 | | |
| Education | -,069 | ,103 | -,669 | | |
| Managerial experience | -,095 | ,105 | -,901 | | |
| Strategic | ,07 | ,09 | ,832 | | |

| | | | | | |
|---|---|---|---|---|---|
| flexibility | 5 | 0 | | | |
| Perceived Risk | ,221* | ,102 | 2,179* | | |
| Formalization | ,195* | ,093 | 2,106* | | |
| *Model 3 F(9-67)= 3,365* | | | | 0.311 | 0.070 |
| Gender | ,276 | ,228 | 1,212 | | |
| Age | ,108 | ,075 | 1,432 | | |
| Education | -,072 | ,100 | -,725 | | |
| Managerial experience | -,120 | ,102 | -1,173 | | |
| Strategic flexibility | -,106 | ,262 | -,404 | | |
| Perceived Risk | ,871** | ,269 | 3,240** | | |
| Formalization | ,794* | ,389 | 2,040* | | |
| Strategic flexibility*Formalization | ,055 | ,080 | ,679 | | |
| Perceived Risk*Formalization | -,230* | ,089 | -2,591* | | |

**Notes:** β indicates unstandardized regression coefficient. *p< 0.05; **p< 0.01

Dependent variables: Affective Commitment

The results showed that Model 3 was significant ($R^2$=0.311; $F_{(9-67)}$ = 3.365; p <0.05). For affective commitment of senior executives and middle managers, Model 3 shows that the interaction between strategic flexibility and formalization is positive but not significant (β= 0.055; p> 0.05). Thus, H3 was not supported. That is, formalization did not moderate the relationship between strategic flexibility and affective commitment. On the other hand, the interaction of perceived risk and formalization had a negative effect on affective commitment (β= -0.230; p <0.05), thereby meeting H4. The interaction term explained additional 7.0 percent of the variance in affective commitment. Formalization moderated only the relationship between perceived risk and affective commitment.

# CONCLUSION

In this study, the effects of strategic flexibility and perceived risk on affective commitment were analyzed. According to the senior executives and middle managers, affective commitment was found to be positively related to strategic flexibility, perceived risk and formalization. The present findings are consistent with previous studies (Roca-Puig et al., 2005; Morris and Steers, 1980; Bowen and Chen, 2001). Unlike previous studies, the interaction between strategic flexibility and formalization does not have a significant effect on affective commitment. Namely, formalization did not moderate the relations between strategic flexibility and affective commitment. However, the findings of the research suggested that the interaction of perceived risk and formalization had a negative effect on affective commitment. Shortly, formalization moderated only the relationship between perceived risk and affective commitment.

The findings of this study need to be interpreted with the following limitations in mind. First limitation is that the results cannot be construed to be representative of all senior executives and middle manager in hotel businesses around the world due to the highly limited nature of the sample. Therefore, the study needs to be replicated in different industrial settings. Moreover, since these findings may be subject to cultural and economics factors, there is also a need to replicate the study in cultural and economic contexts that differ from the present one. Second, participants may have been biased to present positive aspects of their businesses. Thirdly, we relied on a new scale to assess the dimensions of perceived risk. The scale used at this research hasn't proven reliability in many different settings/countries. As with any new measure; further tests in additional samples would help to establish our confidence in it.

There are several potential areas for future research. First, the relationships between social-identity functions and perceived risk are in need of investigation. Second, it would be interesting to establish the specific reasons of strategic flexibility for different industries or organizations.

## REFERENCES


Abraham, R. (2000), Organizational cynicism: Bases and consequences, *Genetic, Social, and General Psychology Monographs,* 126 (3): 269-292.

Addae, H. M. and Parboteeah, K. P. and Velinor, N. (2008), Role stressors and organizational commitment: public sector employment in St Lucia, *International Journal of Manpower*, 29 (6): 567-582.

Akdogan, A. A., Ozgener, S., Tanc, A. and Kaya, Y. (2008), A comparison of perceptions of whistleblowing between senior executives and internal auditors in Turkey. *Professional Ethics in Business and Social Life, Oct. 17-19, 2008, Hacettepe University Centre for Business and Professional Ethics, Antalya-Turkey: 239-248.*

Allen, N.J. and Meyer, J.P. (1990), The measurement and antecedents of affective, continuance and normative commitment, *Journal of Occupational Psychology*, 63: 1-18.

Aube´, C. Rousseau, V., and Morin, E. M. (2007), Perceived organizational support and organizational commitment: The moderating effect of locus of control and work autonomy, *Journal of Managerial Psychology*, 22 (5): 479-495.

Barringer, B.R. and Bluedorn, A.C. (1999), The relationship between corporate entrepreneurship and strategic management, *Strategic Management Journal*, 20: 421-44.

Bodewes, W.E.J. (2002), Formalization and innovation revisited, *European Journal of Innovation Management*, 5(4): 214-223.

Bowen, J. T. and Chen, S. (2001), The relationship between customer loyalty and customer satisfaction, *International Journal of Contemporary Hospitality Management*, 13 (5): 213-217.

Celuch, K., Murphy, G.B., Callaway, S. K. (2007), More bang for your buck: Small firms and the importance of aligned information technology capabilities and strategic flexibility, Journal *of High Technology Management Research*, 17: 187–197.

Cohen, J. and P. Cohen. (1983), Applied multiple regression/correlation analysis for the behavior sciences, 2nd ed., Lawrence Erlbaum Associates, Hillsdale, NJ.

Daugherty, P. J., Stank, P. T., and Rogers, D.S. (1992), The impact of formalization on wharehousing firms, *The International Journal of Logistics Management*, 3(2): 49-62.

Dibrell, C., Down, J., and Bull, L. (2007), Dynamic strategic planning: Achieving strategic flexibility through formalization, *Journal of Business and Management*, 13 (1): 21-35.

Finlay, W., Martin, J., Roman, P., and Blum, T. (1995), Organizational structure and job satisfaction: Do bureaucratic organizations produce more satisfied employees?, *Administration and Society, 27:* 427–450.

Forlani, D., Parthasarathy, M., and Keaveney, S. M. (2008), Managerial risk perceptions of international entry-mode strategies: The interaction effect of control and capability, *International Marketing Review*, 25 (3): 292-311.

Gomez-Gras, J. M., and Verdu-Jover, A. J. (2005), TQM, structural and strategic flexibility and performance: an empirical research study, *Total Quality Management,* 16 (7): 841–860.

Hirunyawipada, T. and Paswan, A. K. (2006), Consumer innovativeness and perceived risk: implications for high technology product adoption, *Journal of Consumer Marketing*, 23(4): 182–198.

Hitt, M. A., Keats, B. W., and DeMaiie, S. M. (1998), Navigating in the new competitive landscape: Building strategic flexibility and competitive advantage in the 21st century, *Academy of Management Executive,* 12 (4): 22-42.

Johnson, M. S., Sivadas, E., and Garbarino, E. (2008), Customer satisfaction, perceived risk and affective commitment: an investigation of directions of influence, *Journal of Services Marketing,* 22 (5): 353–362.

Lambert, E. G., Paoline III, E. A., Lynne Hogan, N. (2006), The impact of centralization and formalization on correctional staff job, satisfaction and organizational commitment: An exploratory study, *Criminal Justice Studies,* 19(1): 23–44.

Lin, C., and Chen, Y. (2009), Hedging strategic flexibility in the distribution optimization problem, *Omega* 37 (4): 826 – 837.

Luchak, A.A., and Gellatly, I. R. (2007), A comparison of linear and nonlinear relations between organizational commitment and work outcomes, *Journal of Applied Psychology,* 92 (3): 786-793.

Michaels, R. E., Dubinsky, A., Kotabe, M., and Lim, C.U. (1996), The effects of organizational formalization on organizational commitment and work alienation in US, Japanese and Korean industrial salesforces, *European Journal of Marketing*, 30(7): 8-24.

Mitchell, V. (1999), Consumer perceived risk: conceptualisations and models, *European Journal of Marketing*, 33 (1/2): 163-195.

Morris, J., and Steers, R. (1980), Structural influences on organizational commitment, *Journal of Vocational Behavior,* 17: 50–57.

Nadkarni, S., and Narayanan, V. K. (2007), Strategic schemas, strategic flexibility, and firm performance: the moderating role of industry clockspeed, *Strategic Management Journal,* 28: 243–270.

Nunnaly, J. C. (1978), Psychometric theory, 2nd edn. New York, McGraw-Hill.

Oldham, G., and Hackman, J. (1981). Relationships between organizational structure and employee reactions: Comparing alternative frameworks. *Administrative Science Quarterly,* 26: 66–83.

Roca-Puig, V., Beltrdn-Martin, I., Escrig-Tena, A. B. and Bou-Llusar, J. C. (2005), Strategic flexibility as a moderator of the relationship between commitment to employees and performance in service firms, *The International Journal of Human Resource Management*, 16(11): 2075-2093.

Sweeney, J.C., Soutar, G.N. and Johnson, L.W. (1999), The role of perceived risk in the quality-value relationship: a study in a retail environment, *Journal of Retailing*, 75: 77-105.

Vandenberghe, C., Bentein, K., Michon, R., Chebat, J. C., and Fils, J. F. (2007), An examination of the role of perceived support and employee commitment in employee–customer encounters, *Journal of Applied Psychology, 92* (4): 1177–1187.

Yeoh, P. (2005), A conceptual framework of antecedents of information search in exporting importance of ability and motivation, *International Marketing Review*, 22 (2): 165-198.

Zhang, M. J. (2005), Information systems, strategic flexibility and firm performance: An empirical investigation, *Journal of Engineering and Technology Management*, 22: 163–184.

# ARE THE WORKERS AND MANAGERS HAVING SAME LEVEL COMMITMENT TO ORGANIZATION? A RESEARCH IN ORGANIZATIONAL ECHELONS WITH LOGISTIC REGRESSION MODEL OF IMPLICATION OF QUASI VARIANCE

**Asli Ekmekci**
**Marmara University, Turkey**

**Nilay Yucel**
**Murat Kasimoglu**
**Canakkale Onsekiz Mart University, Turkey**

## ABSTRACT

*The aim of this study was to examine the factors affecting the organizational commitment in different organizational levels. The empirical research was conducted with the participation of managers, foremen and workers who work in furniture sector. In this case, a survey was conducted in ten furniture companies that employ workers above ten in Çanakkale. There were 27 involvements in the manager level, 34 involvements in the foremen level and 140 involvements in the level of workers to the survey. At the end of this study, a few important results were produced in organizational aspect. It was found that there is a meaningful difference especially between manager in administrative position and operational level workers.*

***Keywords:*** *organizational commitment, organizational echelons, quasi variance*

## INTRODUCTION

Organizational commitment of employees has been a commonly studied issue recently. There are many definitions of organizational commitment in the related literature. Organizational commitment is a strong belief in and acceptance of the organization's goals and values, a willingness to exert considerable effort on behalf of the organization, and a strong desire to remain in the organization (Mowday, Porter and Steers, 1982 as cited in Chen and Chen, 2008, p.283). Another most commonly used definition of organization commitment was provided by Allen and Meyer (1990) "a psychological state that binds the individual to the organization".

It is stated that organizational commitment represents an employee's orientation toward the organization in terms of his or her loyalty to, identification with and involvement in the organization (Robbins and Decenzo, 2004). Committed employees identify with and agree to pursue the company's mission (Dessler, 2004). Moreover, committed employees ensure that the products or services which are involved with are of a high quality can respond to changes in customer demands, contain innovative features and will have no negative impact on the wider community as well (Newell, 1995). Thus, commitment refers that workers will share the leader's viewpoint and willingly fulfill instructions and commitment can be seen as resource for organizations, contributing for to foster the organizational effectiveness and efficiency. As it is suggested, the overall success is high as much as commitment level is high.
Furthermore, organizational commitment is defined as "the psychological attachment of workers to their organization" (Chen, Tsui and Farh, 2002, p.340). It was indicated that commitment to an organization related positively with a variety of positive work outcomes, including job satisfaction, motivation, and

performance. On the other side, it was demonstrated that organizational commitment negatively correlated with undesirable work outcomes, including absenteeism and turnover (Chen and Chen, 2008, p.283).

The original definition of organizational commitment proposed by Mowday, Porter, and Steers includes three components (As cited in Chen and Chen, 2008, p.283). These are acceptance of organizational goals and values, extra effort on behalf of the organization, and a desire to remain with the employer.

O'Reilly and Chatmen (1986) have explained the organizational commitment construct as one focused on the basis of an employee's psychological attachment to the organization. They distinguished three elements of commitment as compliance, identification, and internalization, and suggested that these three elements of commitment may represent separate dimensions of commitment.

In this framework, it was suggested that compliance would occur when an employee accepts influence because he hopes to achieve a favorable reaction from another person or group (O'Reilly and Chatman, 1986). The employee adopts the induced behavior not because he believes in its content but because he expects to gain specific rewards or approval and avoid specific punishments or disapproval by conforming. Compliance (or exchange) occurs when attitudes and behaviors are adopted not because of shared beliefs but simply to gain specific rewards (instrumental involvement for specific, extrinsic rewards). (O'Reilly and Chatman, 1986). From another perspective, compliance brings acceptance of organizational goals and influence not because of a personal belief in the organization, but because of a desire to gain rewards and avoid punishment (Vandenberg, Self, and Seo, 1994, p.125).

Another dimension of O'Reilly and Chatmen's commitment construct is the "identification" which occurs when an employee accepts influence because he or she wants to establish or maintain a satisfying self-defining relationship to another person or a group. It was mentioned that in such kind of a relationship the individual would take over the role of the other, or a form of a reciprocal role relationship will occur. Thus, it was implied that the employee would adopt the induced behavior because it is associated with the desired relationship. (O'Reilly and Chatman, 1986) Therefore, it was indicated that identification occurs when an employee accepts influence to establish or maintain a satisfying relationship and the employee may feel comfortable to be a part of a group, respecting its values and accomplishments without adopting them as his or her own (O'Reilly and Chatman, 1986).

The third dimension of O'Reilly and Chatmen's commitment construct is the "internalization" which emphasizes the acceptance of organizational influence and goal attachment through a perceived congruence between an employee's personal values and the values of the organization (Vandenberg et al., 1994). It was mentioned that when an employee accepts influence because the content of the induced behavior—the ideas and actions of which it is composed—is intrinsically rewarding, internalization can occur. It means that the employee adopts the induced behavior because it is compatible with his value system. In other words, internalization occurs when the employee accepts the influence because the induced attitudes and behavior are congruent with one's own values which mean that the values of the individual and the group or organization are the same (O'Reilly and Chatman, 1986). Therefore, it can be stated that identification is acceptance of influence and goal attachment to maintain satisfying relationships with organizational members (Vandenberg et al., 1994).

As it was indicated, there are various models developed for studying organizational commitment. One of the more comprehensive and recent conceptualizations of organizational commitment is the Meyer and Allen model (1990). Allen and Meyer also define organization commitment as a multidimensional construct. According to their implications, there are three different types of organizational commitment: These are affective, normative, and continuance commitment. Affective commitment is "the employee's emotional attachment to, identification with and involvement in the organization" (Erben and Güneşer, 2008, p.960). Employees with a strong affective commitment continue employment with the organization because they want to do so (Wasti, 2003, p.535). The normative commitment is defined as a "feeling of obligation to continue employment" (Meyer and Allen, 1991). Employees with a high level of normative commitment feel they ought to remain with the organization (Wasti, 2003, p.535). Finally, continuance commitment occurs as a result of "an awareness of the costs associated with leaving the organization" (Erben and Güneşer, 2008, p.960). The continuance component refers to commitment based on the costs that employees associate with leaving the organization. Employees whose primary link to the organization is based on continuance commitment remain because they need to do so (Wasti, 2003, p.535). It is implied that each dimension of organizational commitment will contribute to an employee's relationship with the organization, will have implications for their continuing membership and may be affected by different antecedents or may have different consequences (Meyer and Allen, 1991).

# MODEL AND SAMPLE

Determining the effect of categorical variant has an important role in empirical studies. In this case, the comparisons between the parameters in the model help to prove the effect of categorical variant. Quasi variant provides easiness to reveal these effects.

It is shown that there is a joint problem categorical predictions effect of community in multivariate regression, generalized regression, hazard model. If parameters $\beta_1, \beta_2, \ldots, \beta_k$ are expressed like this, liner contrast is the combination of $c^T\beta = c_1\beta_1 + c_2\beta_2 + \ldots + c_k\beta_k$. $c_1 + \ldots c_k$ =0 constant vector is shown with "c".
Standard statistical programs are explained category effect while it is accepted one of category "0". This is called as "reference" category. In the analysis process this category effect is fixed as ($\beta_1$=0) and compare with k-1 (Firth, 2004:65). From covariant matrix,
$\hat{\text{var}}\,(\sum_{i=1}^{k} c_i\hat{\beta}_i) \approx \sum_{i=1}^{k} c_i^{\,2} q_i$ , it is approximated quasi variance $q_1, \ldots, q_k$. Quasi variance is calculated by quasi variance on the log scale (log $(q_i + q_j) - \log v_{ij}$), it is selected square of errors of means.

One of the most important problems in the application of multi regression, generalized linear model, generalized cumulative model, rational hazard model and more models is the cumulative effect of categorical prediction variant. When "k" represents the level of concerned factor in generalized linear model, the explanation of linear concerned effects expressed as the difference between $\beta$.
In our experiment, the standard errors of differences were calculated by using the following model.

S.e difference=$\sqrt{quasi\,\text{var}\left(\hat{\beta}_3\right) + quasi\,\text{var}\left(\hat{\beta}_2\right)}$

The basic parameters of experiment hypothesis were analyzed by Wald t test (Gayle&Lambert, 2007).

t= $\dfrac{\hat{\beta}_3 - \hat{\beta}_2}{s.e.difference}$

Standard statistical programs accept one category of variant as zero while presenting the effect of categorical explanatory variant. This category is expressed as "basic" or "reference". During the analysis the effect of reference category is fixed as zero and the process maintains.

The sample of this experiment contains managers, foremen and apprentices who work in furniture sector. In this case, a survey was conducted in ten furniture companies that employ workers above ten in Çanakkale. There were 27 involvements in the manager level, 34 involvements in the foremen level and 140 involvements in the level of workers to the survey.

# FINDINGS AND THE RESULTS OF EXPERIMENT

The analysis of logistic regression was made to evaluate the data. Dependent variant seen as the level of workers' relation (0=discontent, 1=content).

While survey questions were preparing a literature scanning was made, the questions aimed at surveying relation sense made by using scales that are generally accepted in literature (Luthans, 1994).

For the analysis of logistic regression, dependent variants were firstly transformed a question has three options. So that, 5= I completely agree, 4= I agree options became I agree with the code "1", for 1= I don't agree at all, 2= I don't agree options the code "0" was given and the questions in 5 scales became 2 optional questions. Because of the option 3=Not sure does not have a certain judgment, it was precluded by filtering in the packed program. Because the researcher were near the answerers and the necessary explanation was made during answering the surveys, it avoided to appear lots of uncertain answers.

The questions evaluate the relation of workers to company;

- Question 1: I feel myself as a part of this company.
- Question 2: I am proud of working in this company.
- Question 3: I believe that being personnel of our company is a privilege.
- Question 4: People respect me in the company I work.
- Question 5: I am appreciated in the company I work.
- Question 6: Our firm takes necessary measures about job security.

The reliability of the questions measure the sense of relation was found Cronbach a= 0, 85. It indicates that the scale is very reliable.

Independent variants are in the model as workers' sex, their position in the company they work, (1=worker, 2=foreman, 3=medium manager, 4=senior manager) and the bigness of the companies (1=small, 2=medium).

In the table 1, results are seen from the analysis of regression. All the independent variants were seen meaningful for the model (sig<0.05). We focused on the function variant as a multiple categorical variant in our study.

**Table 1: Results of Logistic Regression**

| | Model 1 | | | | | Model 2 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Standard Error | Sig. | $\beta$ | Exp ( $\beta$ ) %95 confidence intervals | | Standard Error | Sig. | $\beta$ | Exp ( $\beta$ ) %95 confidence intervals | |
| | | | | Lower | Upper | | | | Lower | Upper |
| Constant | 0.740 | 0.128 | -3.34 | - | - | 0.744 | 0.00 | -1.133 | - | - |
| Workers | 0.439 | 0.013 | 1.086 | 1.253 | 6.997 | - | - | - | - | - |
| Foreman | 0.585 | 0.027 | 1.293 | 1.157 | 11.473 | 0.585 | 0.027 | -.1.293 | 0.087 | 0.865 |
| Middle level managers | 0.473 | 0.00 | 2.215 | 3.624 | 23.179 | 0.582 | 0.011 | 0.923 | 0.804 | 7.871 |
| Top level managers | - | - | - | - | - | 0.555 | 0.009 | -0.207 | 0.274 | 2.410 |
| Sex | | 0.009 | -9.14 | 0.201 | 0.799 | 0.352 | 0.009 | -9.14 | 0.201 | 0.799 |
| Size | 0.351 | 0.015 | -0.857 | 0.213 | 0.845 | 0.351 | 0.015 | -0.85 | 0.213 | 0.845 |

Two different models were created for different reference categories in the study. For the Model 1 that accept senior managers as reference and Model 2 that accept workers as reference, three hypothesis developed separately for each model to test the difference between the categories were evaluated.

Model 1 Hypothesis

*1) Ho: There is no difference between medium manager and foreman* **about organizational commitment**.

*2) Ho: There is no difference between medium manager and workers* **about organizational commitment**.

*3) Ho: There is no difference between foreman and workers* **about organizational commitment**.

Model 2 Hypothesis

*1) Ho: There is no difference between medium manager and foreman* **about organizational commitment**.

*2) Ho: There is no difference between medium manager and senior manager* **about organizational commitment**.

*3) Ho: There is no difference between foreman and senior manager* **about organizational commitment**.

**Table 2: Quasi-variances and Quasi-SEs**

| | Model 1 | | Model 2 | |
|---|---|---|---|---|
| | SE | quasiVar | SE | quasiVar |
| Workers | 0.347 | 0.1206 | 0.116 | 0.0135 |
| Foreman | 0.135 | 0.0182 | 0.181 | 0.0329 |
| Middle level managers | 0.319 | 0.1018 | 0.111 | 0.0122 |
| Top level managers | 0.160 | 0.0255 | 0.346 | 0.1198 |

The reliability of the first hypothesis in the first model of the study was calculated as in the following. The other hypothesis also was calculated by using the same equation and the results were shown in the table.

S.e difference= $\sqrt{0{,}1018 + 0{,}0182}$ = 0,346

t= (2,215-1,293)/0,346=2, 66

In the analysis, because t=2, 66 value was bigger than interval value in the 0, 05 meaning level ($\pm$1.96), a statistically meaningful difference was found between the levels of relation of foremen and medium managers. This situation is essentially important to be evaluated in terms of management and organizational system. In the first model, there can be a few important reasons that the organizational relation level is different for managers and them in operational system. It indicates that there are important similarities between them especially in the operational level about working conditions and their view for company because there is no difference between workers and foreman or they have similar results. Because the managers are on the decision point, their attitudes and behaviors to the organizational system appear in a different way.

**Table 3: The Results of Model**

| | Model 1 | | Model 2 | |
|---|---|---|---|---|
| | s.e.difference | t | s.e.difference | T |
| Middel level managers and foremen | 0.35 | 2.6* | | |
| Middle level managers and workers | 0.47 | 2.4* | | |
| Foreman and workers | 0.37 | 0.55 | | |
| Middle level managers and foremen | | | 0.21 | -10.55* |
| Middle level managers and top level managers | | | 0.363 | -3.19* |
| Foreman and top level managers | | | 0.39 | -2.78* |

In Table 3, hypothesis results done for Model 1 and Model 2 are seen. The values marked with (*) are statistically meaningful in the %95 reliable level.

As understood from the Table, t=2.4 value found for second hypothesis indicates that there is no difference between medium manager and workers is bigger than interval values ($\pm$1.96) determined in the 0.05 meaning level. Testing result shows that there is a meaningful difference between the relation levels of medium managers and workers.

When look at the results for testing the third hypothesis that states there is no difference between forehead and workers, because t=0.55 value is smaller than interval values in the 0.05 meaning level ($\pm$1.96), it was decided that there is no meaningful difference between the relation levels of forehead and workers.

The entire hypothesis for Model 2 is statistically meaningful. When the relation level of workers accepted as reference category, a meaningful difference was seen between "medium manager and foreman", "medium manager and senior manager" and "foreman and senior managers".

## THE RESULT AND GENERAL EVALUATION

At the end of this study, a few important results were produced in organizational aspect. It was found that there is a meaningful difference especially between the organizational managers' work in administrative position and they work in operational level. When the dynamics of furniture sector considered, it is really seen that there are important differences between the conditions and financial opportunities of managers and workers. Important handicaps may appear about workers' relation to their companies because essentially the income level of most workers is at the minimum fee and the rate off the record working is very high because of the structure of sector. Also, when the companies examined that survey was made for, labor circulation speed's being at the very high level is very important about showing the general picture of the situation.

On the contrary, the position of managers in the organizational system partly better. Especially that their salary was better, their insurance and similar rights were fulfilled exactly was seen during the study. Naturally this situation affects the organizational relation in the manager level.

In the future phases, it is considered that making especially this kind of studies between managers and workers in the different sectors and have different income levels is important. Especially providing sample variety, dealing with the subject in different sectors is very important in terms of presenting the validity of the subject. This point will be very ambitious approach for loyalty evaluations done for different stages of organizations in terms of managers and workers. So it is thought that the subject should be repeated in the same sector in the future phases.

Workers in modern organizational systems are very important for their companies. So, workers' having positive attitude and behavior to their organizations is very important in the area of work efficiency and competition. Developing the level of organizational relation is significant at this point. Providing the organizational relation at the high level helps companies' growing and rolls back the rate of labor in factor cost further. Nowadays, several foundations develop programs for improving workers' organizational relation in this manner. By this way, they create a team more dependent on their companies. Moreover, applied programs for developing organizations try to identifying an important part of workers with their companies. Thus, important declines appear in labor circulation speed in organizational aspect and happier workers are created in business life.

# REFERENCES


Allen, N.J., Meyer, J.P. (1990). The measurement and antecedents of affective, continuance and normative commitment to the organization. *Journal of Occupational Psychology*, *63*, 1–18.

Chen, H.F., Chen, Y.C. (2008). The Impact of Work Redesign and Psychological Empowerment on Organizational Commitment. *Public Personnel Management, 37*(3), 279-302.

Chen, Z.X., Tsui, A.S., Farh, J.L. (2002). Loyalty to supervisor vs. Organizational commitment: relationships to employee performance in China. *Journal of Occupational and Organizational Psychology, 75*, 339-356.

Dessler, G. (2004). *Management: Principles and practices for tomorrow's leaders,* 3rd Ed., Pearson Prentice Hall, New Jersey.

Erben, G.S., Güneşer, A.B. (2008). The relationship between paternalistic leadership and organizational commitment: Investigating the role of climate regarding ethics. *Journal of Business Ethics, 82*, 955–968.

Firth, David and Renee X. De Menezes. "Quasi Variance", *Biometrika*, Volume 91 (1), 65-80, 2004.

Firth, David. "Overcoming The Reference Category Problem in The Presentation of Statistical Models", *Sociological Methodology*, Volume 33, 1-18, 2003.

Firth, David. "Quasi-variance in Xlisp-Stat and on the Web", *Journal of Statistical Software*, Volume 5 (4), 1-13, 2000.

Gayle, Vernon and Paul S. Lambert. " Using Quasi-variance to Communicate Sociological Results from Statistical Models", *Sociology,* Volume 41 (6):1191-1208, 2007.

Luthans, Fred. *Organizational Behavior*, Altıncı Baskı, New-York: McGraw- Hill , 1992

Meyer, J. P., Allen, N.J. (1991). A three-component conceptualization of organizational commitment. *Human Resource Management Review, 1* (1), 61–89.

Newell, S. (1995). *The healthy organization: Fairness, ethics, and effective management*, Routledge, London.

O'Reilly, C.A., Chatman, J. (1986). Organizational commitment and psychological attachment: The effects of compliance, identification, and internalization on prosocial behavior. *Journal of Applied Psychology*, *71*(3), 492-499.

Robbins, S.P., Decenzo, D.A. (2004). *Fundamentals of management: Essential concepts and applications,* 4th Ed., Prentice Hall, New Jersey.

Vandenberg, R.J., Self, R.M., Seo, J.H. (1994). A critical examination of the internalization, identification, and compliance commitment measures. *Journal of Management*, *20* (1), 123-140.

Wasti, A. (2003). The influence of cultural values on antecedents of organizational commitment: An individual-level analysis. *Applied Psychology: An International Review, 52* (4), 533-554.

# THE PROCESS OF CROSS-CULTURAL BUSINESS NEGOTIATIONS: A COMPARISON OF AMERICAN, JAPANESE AND TURKISH APPROACHES

**Sibel Nitelik**
**Industrial Engineer, Turkey**

## ABSTRACT

*In this age of the global economy, cross-cultural negotiations are becoming increasingly important in the management and marketing process of many companies. Managers increasingly engage themselves in international business negotiations and managers may spend more than 50 per cent of their time negotiating (Adler, 1997). As Phatak and Habib (1996, p: 30) aptly point out, "There can be no international business without the presence of at least two parties, each coming from different countries, sitting face to face and negotiating a business deal". Therefore, international negotiation is one of the most important and indispensable skills in all kinds of international business.*

*The purpose of the present study is to investigate critically the role of cultural differences on the business negotiation process. In the research, American, Japanese, Turkish negotiations' processes are compared.*

***Keywords:****Cross-cultural business negotiations, International negotiation strategies, American business negotiations, Japan business negotiations, the process of negotiations*

## INTRODUCTION

International business negotiations have many characteristics that distinguish them from negotiations in the domestic setting (Wimsatt&Gassenheimer, 1996, p:25). This means negotiators interact with individuals from unfamiliar cultures that exhibit different bargain styles, behaviours and expectations about the normal process of negotiation (Graham & Sano, 1984). As McCall and Warrington (1989, p:15) explain "negotiators entering relationships with one another bring to their interactions variations in prior experience, background and outlook…They shape the way an individual reacts to the negotiating environment". In this case, it is necessary to be aware of representatives' competitive or co-operative positioning on the continuum or inherent individual characteristics impacting social interactions in cross- cultural bargaining and negotiation in order to take it as an advantage for the firms (Rubin&Brown, 1976, p:294).

## LITERATURE REVIEW

### 1. International Business Negotiations

According to the Robbins (2003, p:518) negotiation permeates the interactions of almost everywhere in groups and organizations. Managers negotiate with subordinates, peers, and bosses; salespeople negotiate with customers; purchasing agents negotiate with suppliers. Negotiation is "the use of information and power to affect behaviour within a web of tension" (Cohen, 1980, p: 16, cited Kramer& Herbig, 1997, p:187-195).

Casse (1981, p:152) defines negotiation as, "a process in which at least one individual with different needs and viewpoints try to reach agreement on matters of mutual interest". Similarly, the term 'business negotiation' is used by Thomas (2002, p:145) to refer "a communication in which the parties have a need to reach an agreement, but have potentially conflicting interests".

## 2. Cross-Cultural Business Negotiations

A negotiation is cross-cultural "when the parties involved belong to different cultures and therefore do not share the same ways of thinking, feeling and behaving" (Casse, 1981, p. 152).

The negotiation process is generally more complex because it encompasses unconscious forces of the different cultural norms that may undermine effective communication (Chen, 1995). In the negotiation process, McCall and Warrington (1989) described interpersonal communication as the key activity that takes place at the verbal, nonverbal, situational, contextual and social structural levels and constitutes a total communication system that can assist the negotiator to bridge the gap between utterance and felt meaning. Thus, in a cross-cultural negotiation, in addition to the basic negotiation skills, it is important to understand the cultural differences, and to modify the negotiation style accordingly (Simintiras& Thomas, 1998).

## 3. The Process of Cross Cultural Business Negotiations

There is no general agreement in the literature on the precise definition of each stage in the negotiation process. Also, when looking at the styles of different negotiators from different cultures, there are different emphases on the various phases of negotiation. Graham and Herberger (1983) distinguish four stages: 1) non-task relationship creation, 2) task-related exchange information, 3) persuasion, 4) concession and agreement. Mead (1990) suggests that this type of sequential approach to understanding the process of negotiation is over- systematic. Mead (1990, p: 255) therefore, prefers to think of this process in terms of topic areas rather than sequential stages as follows.

- Creating a relationship
- Finding common ground
- Persuasion
- Bargaining and conceding
- Implementation

On the other hand, Fowler (1986) argued that all negotiation processes follow a three-stage frame:

(1) The first stage is concerned with the preliminaries as the sequence of events, which lead to negotiation occurring.
(2) The second stage focuses on the negotiation itself as what happens in the course of the process, which may be broken down into conceptualization, planning, execution and control.
(3) The final stage is related to the conclusion of the negotiation, whether an outcome is reached that is acceptable for both parties.

However, roughly speaking, negotiation process can be divided into four main stages. These are non-task sounding, task related exchange information, persuasion, concession and agreement. Despite the consistency of this process across cultures, the content and duration of the four stages differ substantially between different cultures.

### 3.1. Non-task sounding

The first stage describes the process of getting to know each other or of establishing rapport between members of negotiating teams (Adler **et al.**, 1987; Hawrysh and Zaichkowsky, 1989 cited Simintiras&Thomas, 1998, p: 10-28). This stage is often more important than the formal negotiation stage, as parties can develop social, informal relationships. Trust and confidence gained from these relationships increase the chance of an agreement (Cateora&Ghauri, 2000, p: 408).

### 3.2. Task related exchange information

The second stage of the negotiation describes the task-related interaction and it is concerned with the "business" of the negotiation Simintiras&Thomas, 1998). Negotiators focus on presenting their situation and needs (Adler, 2002). For some cultures this is the most important step in the negotiating process. Those from high context cultures, such as the Chinese, Japanese, and Mexicans, are precisely those who spend a good deal of time on this non task sounding stage. The personal and organizational information that they seek provides them the context that is so important for understanding messages in their culture (Mcfarlin&Sweeney, 1998, p: 205).

### 3.3. Persuasion

The persuasion phase of the negotiation process involves the parties' attempts to modify one another's performance expectations through the use of various persuasive tactics (Hawrysh & Zaichkowsky, 1989). At this stage, one party can offer promises, make threats, or ask for concessions in order to try to persuade the other to accept conditions or give way on points (Holt, 1998). In Japan, there is not a clear separation of information seeking and persuasion. The two stages tend to blend together as each side more clearly defines and refines its needs and preferences. So much time is spent at this task-related exchange of information that little is left to discuss during the persuasion stage. The Japanese believe that little persuasion should be necessary if the parties have taken the time to understand each other thoroughly (Gulbro&Herbig, 1995).

### 3.4. Concession and agreement

It reflects the negotiators attempts to move the negotiation process from a point of initial position on each discussion issue to a point of agreement (Rinehart & Page, 1992). Negotiators can make concessions at any stage of the negotiation process. Although the research is not definitive, it appears that negotiators who make early concessions disadvantage themselves in comparison with those making fewer concessions primarily at the end of the bargaining sessions (Rubin&Brown, 1976).

For instance Japanese ask for higher profits when making an initial offer, and are then consistent in making small concessions throughout. Americans are more likely to make larger initial concessions. Another study shows North Americans making small concessions early in order to build the relationship and usually reciprocating concessions (Mead, 1998, p: 247).

Negotiations are entered into only for the purpose of reaching an agreement. An agreement is an exchange of conditional promises in which each party declares that it will act in a certain way on condition that the other parties act in accordance with their promises (Martin, 1997). Obviously, *reaching an agreement* means much more than achieving the objectives initially set out in formal negotiations. Negotiators should conceive a full range of possible agreements before they actually come to table, and they should then recognize these possibilities as viable objectives of a successful negotiation (Holt, 1998).

In negotiations between Americans and Japanese, Americans owners traditionally concern themselves more with the viability of the enterprise-with its predicted future revenues and profits. Japanese buyers, on the other hand, generally show more interest in market share and in the property and physical plant. A Japanese buyer may find an enterprise particularly valuable for one set of reasons; where as the American owner may place it on the market for an entirely different set of reasons (Adler, 2002, p: 213).

# METHODOLOGY

## 1. Research Strategy and Design

An understanding of the research approach and the extent to which the researcher is clear about the relevant theory at the beginning of the research is extremely important (DePoy&Gitlin, 1994). This level of clarity will help to answer an important question about the design of the research project.

The nature of the aim and objectives set and the interpretive approach taken in the previous section necessitates the use of a similar strategic approach using a combination of methodologies. The main data strategy selected for the research is in-dept interviews. The reason to be selected this type of interview is the interview is given the opportunity to talk freely about events, behavior and beliefs in relation to the topic area (Saunders et al, 2000, p: 247).

## 2. The Structure of the Interview

An interview can be either structured, unstructured, or a combination of both: semi-structured. The interviews were chosen to be semi structured in-dept interviews i.e. a quite informal interview where the author has a list of themes and questions prepared to be covered (Saunders et al 2000). In case studies and qualitative research, in dept interviews are often required in order to get a reliable outcome. However, Aaker and Day (1986) and Selnes (1993) claim that qualitative research like in-dept interviews demands more from both the researcher and the respondent, e.g. time, effort and money.

Four international companies in Turkey were chosen for the interviews and the interviews were done with the general managers and vise-presidents who travel a lot and negotiate with multi cultures. Apart from these there was a chance to record a negotiation at one company while the interview is preceded. Therefore with the company's permission this sample negotiation is used as a data.

Prior to the interviews the possible respondents were sent a letter about an interview via e-mail. In this letter the author introduced herself then explained the aims of this research. The reply was not received within an appropriate number of days, the author called the respondents in order to hear if the inter was possible or not.

In order to avoid forgetting what was said during the interviews, a tape recorder was used.

## 3. Data Collection Methods

As mentioned previously, the author obtained relevant data for the research by using secondary and primary data collection methods. The reasons for utilizing these data collection methods were due to the complexity of the research aim. One of the goals of this research is to make a comparison between Turkish, Japanese and American bargaining styles. To achieve this aim some previous researches were used for the comparison.

# FINDINGS

## 1. Non-Task Sounding

Graham and Sano (2003, cited Ghauri&Usunier, 2003, p: 396) define that the Americans always discuss topics other than business at the negotiation table (e.g. the weather, family, sports, and politics) but not for long. Usually the discussion is moved to the specific business at hand after 5 to 10 min. such preliminary talk is much more than just being friendly or polite.

*The survey results indicate that similarly with Americans, in Turkey, chatting about non-business matters while sipping coffee or tea is a good way to break the ice. While negotiators are having the drinks, very deep, descriptive information about the negotiators' company is given to their business partners. Particularly who they are, what they do, what their past and current experience are, what their position was in the market mentioned. As well as these first impressions such as the attitude in greetings or exchanging the business cards are very important.*

The respondents were asked to categorize the time spent on each activity, which were establishing rapport, position, reflection, evaluation and persuasion, compromise, agreement, review, revision. The average percentages show that Turks spend most of their time in exchanging information and persuasion. After that, establishing rapport comes next. Not surprisingly, as Turks think that getting to know each other is an essential step in the negotiations, the findings show that they spend some time in the first stage. However, agreements are also important for Turks as well as the other steps.

The participants implied that exchange of information was the main part of the negotiation. Questions and clarifications abound with the Turkish attempting to obtain a complete understanding, which to them, essential to the ultimate success of the negotiations. As well as this, establishing rapport is important as much as other parts. If the guests have time, they are taken to the football matches (if they are interested), nice Turkish restaurants, clubs where traditional or international pop, rock music is played, and also historical places in Turkey. Because, it is thought that entertaining and being entertained are essential parts of building a close relationship with your counterpart. Trust and confidence gained from these relationships increase the chance of an agreement.

## 2. Task Related Exchange Information

Theory suggests that for the Japanese, this exchange of information is the main part of the negotiation. A "complete" understanding is imperative. They spend much more time trying to understand the situation and associated details of one another's bargaining position (Graham&Sano, 2003 cited Graham&Usunier, 2003, p: 396). On the side, negotiators from United States tend to say what they want and explain the reasons behind the request only if necessary. That's why the task-related exchange of information goes quickly in America (Graham&Sano, 2003 cited Graham&Usunier, 2003, p: 396). However, in Turkey the results present that like Japanese exchange of information is the main body of negotiations. Turkish spends quite a lot time in this stage. They try to understand the situation, put the comments and discuss all the details.

## 3. Persuasion

Previous studies (Graham&Sano, 2003 cited Graham&Usunier, 2003, p: 396, Martin, 1997, Gulbro&Herbig, 1995) show that Americans tend to spend the most time in the third stage of negotiation-persuasion. They openly disagree and use aggressive persuasive tactics such as threats and warnings. In contrast, Japanese take the time to understand one another during the first two stages of the negotiation; hence, little persuasion is necessary for them. They avoid confrontations and respond to threat by a change of subject, a silent period, or withdrawal.

Several studies (Graham, 1983, Martin, 1997) have revealed that in Japan, only a few persuasive tactics are appropriate: questions, self-disclosures, positive influence tactics, silence, change of subject, recesses and delays, concessions and commitments. The repertoire of persuasive tactics available to bargainers in Japan is prescribed by status/power relations. Aggressive influence tactics can be used only by negotiators in higher power status positions and are communicated only through the low-level, informal communications channels.

In the negotiation, the home party appears to ask much more questions than the host party. Not surprisingly, the host party seems to make more commands and self disclosure.

The number of commitments and recommendations made by the host party is more than home party did. On the other hand, the home party made threat and punishment once whereas the other party did not at all. Therefore, as the table represents that home party used more aggressive and harder persuasion tactics than host party did.

Overall, the home party was more determinant minded whilst the other party was a little bit passive, they did not ask many questions and they were not enough persuasive. It might be because they were not well prepared particularly when the home party insisted on seeing the contract.

Another considerable point in this negotiation was the home party felt they should not trust them. Therefore, they did not guarantee to have a long term relationship with them.

In order to make a comparison between Turkish, Japanese and American verbal behaviors the author used Graham's (1985) findings on the determinants of business negotiation outcomes in the U.S. and Japan.

In 1985, simulated business negotiation in three countries the United States, Japan and Brazil were analyzed using observational methods by Graham. That was, exploratory methods were employed in which negotiation processes were recorded a videotape and both verbal and non verbal behavior during negotiations was compared across the three cultures. In this exploratory study, the respondents were given 40 min. times to do the case study negotiation. The table 3.1 below is adapted from John L. Graham, (1985), "The Influence of Culture on the Process of Business Negotiations: An Exploratory Study," Journal of International Business Studies, spring, 16, 000001, p:88.

Table 3:1 Number of times behaviour was used in a 30 minute Negotiating session by members of each group

| Behaviour (description) | Japanese | US | Turkish |
|---|---|---|---|
| Making promises | 7 | 8 | 4 |
| Making threats | 4 | 4 | 1 |
| Making recommendations | 7 | 4 | 7 |
| Giving warnings | 2 | 1 | 5 |
| Offering rewards | 1 | 2 | 0 |
| Punishment | 1 | 3 | 1 |
| Positive Normative Appeal | 1 | 1 | 0 |
| Negative Normative Appeal | 3 | 1 | 1 |
| Making commitments | 15 | 13 | 2 |
| Asking questions | 20 | 20 | 22 |
| Giving commands | 8 | 6 | 10 |
| Self-disclosure | 34 | 36 | 23 |
| Restatement | it is not included in the analysis | | 2 |

Source: Adapted from John L. Graham, (1985), "The Influence of Culture on the Process of Business Negotiations: An Exploratory Study," Journal of International Business Studies, spring; 16, 000001, p: 88.

As the data illustrates, the number of each category is surprisingly consistent across three groups. The only substantial discrepancy is that the Turkish appear to make less commitments and self-disclosure than either the Americans or Japanese business people do.

The number of questions for the three groups is surprisingly similar. Another point is, as Graham&Sano (2003 cited Graham&Usunier, 2003, p: 396), Martin (1997), Gulbro&Herbig (1995) proved in their research on American negotiation style, the Americans use more aggressive persuasive tactics than Japanese and Turkish do. Looking at totals for commands reveals little difference between the three cultural groups. Furthermore, according to the table, Americans made punishments 3 times whereas the Turkish and the Japanese did once.

On the other hand, Turkish made warnings much more than Americans and Japanese did. The Turkish bargainers made threat once whilst the Japanese and Americans made four times. Therefore, it looks American and Japanese use more hard persuasive tactics compared to Turkish Businessmen. However, Turkish did not give promises as much as Japanese and Americans did.

## 4. Concession and Agreement

*Americans continuously compromise and make modifications to their initial bargaining position. They tend to make concessions throughout, settling one issue, and then proceeding to the next. Therefore, the final agreement is a sequence of several smaller concessions (Graham&Sano, cited Graham&Usunier, 2003, p: 396).*

*In comparison to U.S. bargainers, the Japanese tend to wait until the end phase of negotiations before they make their concessions. The Japanese do not like dealing piecemeal with issues, and this explains why their concessions are bunched toward the end of the negotiation process. Second, even if the Americans are very persuasive, they may get a silent show the source of frustration here (Mcfarlin&Sweeney, 1998, p: 208; Gulbro&Herbig, 1995). The research results provide that to reach an agreement for Turkish people is mutually acceptable, each side must frequently give up some things; therefore, concessions by both sides are necessary to reach an agreement. However, Gesteland (2002, p: 210) indicates in his studies Turks make any concession with reluctance and only on a conditional basis, requiring something equivalent in return for each concession in price, terms or other issues.*

Martin (1997) analyses the structure and the role of contract for Americans in 1997. In this research, he mentioned that US contracts were lengthy; every contingency must be carefully anticipated and thought through ahead of time. Martin (1997) found that the contract became a contract of objectively verifiable and predictable action between two parties. An American would not hesitate to sign a contract with his or her own worst enemy, if it were sufficiently endowed in legal terms. The objective of US negotiators was usually to arrive at legalistic contracts, and therefore, the dominant concern was with getting the details right, and to use all relationships to facilitate the achievement of understandings which are unambiguous.
However, one previous study (Tung, 1983) demonstrates that, to Japanese view contract is secondary in a business transaction, which should be premised on an ongoing, harmonious relationship between two parties. Japanese contracts are always considered open for renegotiation. The Japanese dislike formal, Western-style contracts. They tend to prefer brief, written agreements, which set forth basic principles. Japanese written contracts are in contrast to Americans usually very short - two or three pages are purposefully loosely written and primarily contain comments on principles of the relationship (Martin, 1997).

Japanese negotiators do not mind suggesting major changes even after a contract is signed. They do not believe that a contract alone can ensure the success of a venture. The contract is only a tangible acknowledgement of the existence of such a relationship, not a precise instrument that establishes and defines the relationship (Oikawa & Tanner, 1992).

On the other hand, the findings point out that agreements are the most important international documents that must be negotiated between firms of different nationalities. A contract is an agreement, the success of a venture for Turkish. They do not like the changes once it was signed. Written agreements are always preferred and Turkish would like to see every single detail on the report. Because it is thought 'it is life, today you are working with us but tomorrow maybe you are not. People can change but the job does not'.

## 5. American, Japanese and Turkish Negotiators' Bargaining Styles

Japanese negotiators develop defensive arguments with no consideration of persuading or selling or converting the other side. In addition, they do not usually take account of what the other side might be thinking or offering, or of anticipated strategies, or of any concession strategies. At the bargaining table Japanese prefer to be quiet when right, respectful and patient. Modesty and self-restraint are highly valued in their culture. The Japanese prefer to avoid formal negotiations since, to them, negotiations are a form of social conflict and avoiding social conflict is penultimate in that society (Martin 1997).

In their pursuit of harmony and avoidance of conflict, the Japanese conversational style in both simulated and real business negotiations includes much less eye contact than the American style. This difference seems to cause problems for both sides. The Japanese report discomfort at the "aggressive staring" of the Americans. Americans suggest that "something must be wrong" because the Japanese will not look them in the eye (Graham&Sano, 2003 cited Graham&Usunier, 2003, p: 396). On the other hand, Americans, in foreign eyes, are seen as being extremely argumentative, whether right or wrong, impersonal when arguing, and accommodating when presenting arguments. When challenged, Japanese executives will not argue or even discuss the point; they typically will remain silent (Martin 1997).

Many US negotiators speak louder at the bargaining table than people from more reserved cultures (Lewis, 2000). They are uncomfortable with silence; they may also feel compelled to quickly fill in any gaps in the conversation- a behaviour that Japanese for example find offensive. Americans also know it is rude to interrupt others in mid-sentence (Gesteland, 1999).

The American style is oriented towards several major aspects, which are linked to the US national character, namely individualism with the emphasis on ability, competence, professionalism, decision-making and explicit communication. As a consequence American negotiators usually posses the following qualities: seriousness, pragmatism, and accuracy in writing clauses (Beliaev et al, 1985). They try to convey their own preferences and identify those of the other party by focusing on facts, asking questions, prohibing and looking for specific data (Johansson, 2000).

On Turkish negotiation side the perception that Turkish negotiators talk a lot. However, according to the respondents' opinion, skilled negotiators spent more time listening and asking questions to ensure that they fully understand the other side than they do talking. The ability to listen effectively was fundamental to success of any business negotiation.

The research show that, in Turkish business culture, before the first negotiation if the negotiators did not know each other, as much as information was tried to be received about the country's political and economical situation, the social and cultural environment there and so on. The participants indicated that such information, if known, could help a negotiator resist requests to improve his or her offer. When gathering information, the negotiator should address such questions as who the competitors for this transactions, what his or her company's strengths were versus the competition, and how the competition could affect his or her company's goals in the negotiation.

The respondents were asked to indicate whether the Turkish negotiators are accommodating or exploitative, honest or deceptive, unbiased or biased. The results show that Turkish negotiators seem to be honest and unbiased whereas they are between accommodating and exploitative.

The findings from the sample negotiation represent that in the negotiations, Turkish negotiators firstly consider their objectives. Both of the sides were usually calm and open. They preferred listening to the other side carefully rather than speaking a lot. One participant highlighted that there is a saying 'you cannot guess what a Turk is thinking on his/her mind'. Because they do not say immediately what they are thinking. On the other side, Turks were very impatient people. This was a part of their culture. That's why; they try to avoid making quick decisions. In contrast to participants' opinion in the sample negotiation especially the host party spoke a lot and could not make right decisions for couple times. Therefore, the home party thinks they cannot trust nor do a long-term business with them.

The participants suggested that 'if you want to be successful in business world, you have to have your own tactics and strategies'. For example, role-playing was valuable technique for projects requiring approval by a foreign government or agreement with a foreign company. By practising own roles and those of the counterpart negotiators and by researching the country's culture and history to determine attitudes toward foreign companies-negotiators might be much better able to anticipate responses and plan your own actions. Turks use this technique very much. As a result, Turks tried to go to the negotiation as a team. Before the negotiation, they planned the process, shared the roles, like while one of them was speaking, the other one was responsible for making notes, or they tried to understand them with their attitudes, body language. They prepared themselves very well.

# CONCLUSION

The great diversity of the world's cultures makes it impossible for any negotiator, no matter how skilled and experienced, to understand fully all the cultures that he or she may encounter. How should an international manager prepare to cope with culture in making deals in one country today and at another country next week? One approach is to identify important areas where cultural differences may arise during the negotiation process.

# REFERENCES


- Aaker, D., A., and Day, G., S. (1986) *Marketing Research*. 3rd ed. USA: John Wiley&Sons
- Adler, N. (1997) *International Dimensions of Organizational Behavior,* 3rd ed. Washington, DC: International Thompson Publishing.
- Adler, N. (2002) *International Dimensions of Organizational Behaviour*, 4th ed. Boston, and Massachusetts: PWS-Kent.
- Adler, N.J., Graham, J.L., Gehrke, T.S. (1987) ***Business negotiations in Canada, Mexico, and the United States.*** *Journal of Business Research*, 15, 411-29.
- Beliaev, E., Mullen, T., and Punnet, B. J. (1985) Understanding the Cultural Environment: US-USSR Trade Negotiations. *California Management Review,* 27(2), 100-110.
- Casse, P. (1981) *Training for cross-cultural mind*. 2nd ed. Washington DC: Society for Intercultural Education, Training and Research.
- Cateora, P.R., and Ghauri, P.N. (2000) *International Marketing*. London: McGraw- Hill Publishing.
- Chen, M. (1995) *Asian Management System: Chinese, Japanese and Korean Styles of Business.* London: Rutledge.
- De Poy, E. and Gitlin, L.N. (1994) *Introduction to Research to Multiple Strategies for Health and Human Services*. London: Mosby.
- Fayerweather, J., and Kapoor, A. (1972) ***Simulated international business negotiations.*** *Journal of International Business Studies*, 3, 19-31.
- Fowler, A. (1986) *Effective Negotiation*. London: Institute of Personal Management.
- Gesteland, R.R. (2002) 3rd ed. *Cross-cultural Business Behaviour: marketing, negotiating, sourcing and managing across cultures.* Copenhagen: Copenhagen Business School.
- Graham, J. L., and Sano, Y. (1984) *Smart Bargaining: Doing Business with Japanese*. Cambridge. MA: Ballinger Publishing.
- Graham, J. L., and Sano, Y. (2003) Business Negotiations between Japanese and Americans. In: Ghauri, P., N., and Usunier, J., C. 2003 *International Business negotiations*. 2nd ed. Oxford: Pergamon. 393-411.
- Graham, J.L. (1983) ***Business negotiations in Japan, Brazil, and the United States.*** *Journal of International Business Studies*, Spring-Summer, 14, 000001, 47-62.
- Graham, J. L. (1985) The Influence of Culture on the Process of Business Negotiations: An Exploratory Study. *Journal of International Business Studies*, spring. 81-96.
- Graham, J., L. and Herberger, R., A. (1983) Negotiators abroad 'don't shoot from the hip', *Harvard Business Review*, July/ August, 160-168.
- Gulbro, R., and Herbig, P. (1995) Differences in Cross- Cultural Negotiation Behavior between Industrial Product and Consumer Product Firms. *The Journal of Business and Industrial Marketing*. 10 (3), 18-28.
- Hawrysh, B.M., Zaichkowsky, J.L. (1989) ***Cultural approaches to negotiations: understanding the Japanese***. *International Marketing Review*, 7(2), 28-42.

- Herbig, P., A., and Kramer, H., E. (1997) Measuring intracultural bimodality and cross-cultural diversity in American-Japanese business negotiations. *Journal of Marketing Communications*, 3, 187-195.
- Holt, D., H. (1998) *International management, text and cases*. Fort Worth; London: Dryden Press.
- Johansson, J, K. (2000) *Global marketing: Foreign entry, local marketing, Global management.* 2nd ed. Boston: Irwin McGraw- Hill.
- Lewis, R.D. (2000). *When Cultures Collide: Managing successfully across cultures.* London: Nicholas Brealey.
- Martin, D. (1997) Contractual Aspects of Cross-Cultural Negotiations. *Marketing Intelligence& Planning*, 15 (1), 19-27.
- Mc Call, J, Warrington, M. (1989) *Marketing by Agreement: A Cross-cultural Approach to Business Negotiations*. 2nd ed. Chichester: Wiley.
- Mc Farlin, D.B. and Sweeney, P.D. (1998) *International Management, Trends, Challenges, and Opportunities.* United States of America: Thomson Publishing.
- Mead, R. (1990) *Cross- Cultural Communication*, Chichester: Wiley.
- Mead, R. (1998) *International Management: Cross cultural dimensions.* 2nd ed. London: Blackwell Business.
- Oikawa, N., and Tanner, J., F. (1992) The influence of Japanese culture on business relationships and negotiations. *The journal of services marketing.* Santa Barbara, 6 (3), 67-75.
- Phatak A., Habib, M. (1996) The dynamics of international business negotiations. Business Horızons. May/ June. P: 30-38.
- Rinehart L., M., and Page T., J. (1992) The Development and test of a model of transaction negotiation. *Journal of Marketing*, 56, 18-32.
- Robbins, S., P. (2003) *Organizational Behavior*, 7th ed. Upper Saddle River, NJ: Prentice Hall.
- Rubin, J., Brown, B. (1976) *The Social Psychology of Bargaining and Negotiation.* New York: Academy Press.
- Saunders, M., Lewis, P., Thornhill, A. (2000) *Research Methods for Business Students.* 2nd ed. Harlow: Financial Times, Prentice Hall.
- Selnes, F. (1993) *Marketing Research*. Norway: Bedriftkonomiens Forlag A.S.
- Simintiras &Thomas, 1998. Cross-cultural sales negotiations: A literature review and research propositions. *International Marketing Review*. 15 (1), 10 – 28.
- Thomas, D., C. (2002) *Essentials of International Management: A cross- Cultural Perspective.* London: Thousand Oaks, Calif: Sage.
- Tung, R. (1983) ***How to negotiate with the Japanese***. *California Management Review*, 26 (4), 52-77.
- Wimsatt, A., M., and Gassenheimer, J., B. (1996) Negotiation Differences Between Two Diverse Cultures: An Industrial Seller's Perspective. *European Journal of Marketing*, 15 (5), 340-353.

# A RESEARCH TO DETERMINE THE STRESS FACTORS ON THE EMPLOYEES THAT ARE DISMISSED DUE TO THE DOWNSIZING STRATEGY

**Bünyamin Akdemir**
**Sinem Güravşar Gökçe**

**İnönü University, Turkey**

## ABSTRACT

*The downsizing strategy, which was preferred to compete and behave rationally in 1990s, became compulsory today, with the current global crisis. Downsizing strategy causes important results on organizations, employees and society. These employees, who lost their jobs in this global crisis, are having many difficulties for finding a new job. This situation makes the employees' life more difficult and brings out very serious problems.*

*Due to some complications during the downsizing strategy, some psychological, social and financial effects on employees, their families and their environment occur. These complications decrease people's quality of life and destroy their expectations for the future. Thus, people's hopes diminish and a stressful life becomes compulsory. Due to the reasons of social responsibility, business management should decide by taking the social complications of downsizing strategy into account before execution. This assumption forms the starting point of this study. In this research, the effects of downsizing strategy, which is preferred compulsorily by many companies due to the global crisis, on the stress factors of the dismissed employees are examined. In other words, "to determine and analyze the stress factors on the employees that are dismissed due to the downsizing strategy" is the main purpose of this research.*

**Keywords:** Downsizing strategy, dismissed employees, stress factors.

## INTRODUCTION

Nowadays, the whole world is affected by a serious global crisis. The impact of this global crisis has been gradually felt in our country, as it is in all over the world. Due to this crisis, enterprises have been developing and implementing downsizing strategies to obtain competitive advantages. Defining strategy, which is the responsibility of top level managers and strategists, is a very critical task. The managers and strategists, who take this critical duty and responsibility in global crisis environment, also have to make some decisions by taking the current employees' attitudes, behavior and social structure into account.

Enterprises that are active in this crisis environment prefer the downsizing strategy as an alternative to decrease or avoid the effects of the crisis. Downsizing strategy, especially after 90s, is a management strategy which has important effects on people, enterprises and national economies (Wager, 1998: 302). Downsizing, which can be defined as temporary or permanent elimination of employees, is caused by important changes in the environmental factors (Şenturan, 2005:2).

Downsizing strategy is as an alternative to survive or compete in the crisis environment, but on the other hand, it might be a stress factor for the dismissed employees. In this respect, the managers and the leaders should make their decisions by taking the social complications of downsizing strategy into account. The conceptual scope of this research is composed of downsizing strategy and stress factors affecting stress level of dismissed employees. Accordingly, the application scope is limited to the dismissed employees that are registered in Malatya İŞKUR. Thus, "*to determine and analyze the stress factors on the employees that are* *dismissed due to the downsizing strategy*" is the main purpose of this research. The originality of this research arises from the determination of stress factors affecting dismissed employees and analysis of these stress factors, which are caused by downsizing strategy, by statistical methods.

# LITERATURE REVIEW

## Downsizing Strategy

Especially since the early 90s, with the increasing competition in national and international environment, a rapid change has been experienced. In this process, managers and strategists might have to limit or totally leave some current works temporarily or permanently, if the survival or competitive advantage of the enterprise is in danger (Ülgen and Mirze, 2006: 203). Thus, enterprises were directed to new strategic alternatives to adapt to this change by using the resources more rationally according to the internal and external environmental conditions.

One of these alternatives is saving strategy which is also known as strategy of looking around (Dinçer, 1998: 293). Implementing this strategy is very difficult and most of the strategists do not like to implement it (Eren, 2000: 252). But one of the alternatives within recovery and saving strategies that can be applied during regression and narrowing in economy or in a specific sector, is downsizing strategy, which involves organizational change via reorganization (Dinçer, 1998:294-295). This strategy is preferred ever so often by the global crisis that has been continuing.

***Downsizing strategy is the reduction of labor force systematically to increase the efficiency and performance of the company in accordance with the objectives that are defined before (İslamoğlu, 2002: 95). Downsizing does not include discharge of individual for a cause or individual departures via normal retirement and resignations (Manson, 2000: 10). The enterprises that can plan their future properly can implement downsizing without dismissal of employees (Francis and Pett, 2004: 27). Although downsizing is seemed to be focused on the labor force, since it interests the whole organization it can be evaluated as organizational downsizing. In downsizing strategy, rather than the structure of the organization, activity processes inside the enterprise are reviewed. As a result of this revision the activities except the core competencies are removed or minimized (Jiang and Klein, 2000: 36). In this respect, downsizing strategy can be defined as closing of some departments, units or positions or reviewing of the processes to eliminate the unnecessary ones. Different organizations might implement different corporate arrangements after the execution of downsizing strategy (Mccann, Hassard, and Morris, 2004:28).***

***The aim of downsizing is improving the enterprise and increasing the competitive power. As a result of downsizing strategy, organizations lose their vertical structural properties and gain horizontal structure which provides the cooperation between the functions and processes. In this way, with the downsizing strategy, the layers of the hierarchy and so the functions will decrease (Dahl and Nesheim, 1998:241). The acceptance of "lean and zero hierarchy" in many enterprises due to the crises in last years is an indicator of the utilization level of this strategy (Appelbaum, Lebnanc, and Shopiro, 1998; Dinçer, 1998; Jiang and Klein, 2000).***

## Stress and Factors Affecting Stress Level of Dismissed Employees

***The concept of stress was widely used by the community in daily speeches, before it gained its scientific meaning completely. Almost everybody knows the meaning of stress but there are some differences in defining it. Thus, stress is a scientific concept having the dilemma (like relativity theory) of being known widely but not understood completely (Rice, 1999:4). Shortly, stress is one of the most complicated concepts which is hard to define.***

***In general, stress is evaluated with the individual and his/her environment, as a situation that arises from physical and psychological coercing and tension. Stress is a situation that directs the behaviour and attitudes of people who are affected by environmental, organizational and personal factors (Ertekin, 1993:6). It is a physical and psychological reaction process, which starts physically and continues psychologically, and includes emotional states like sadness, anxiety and depression (Allen, 1983:3).***

In this context, besides the stress concept, it is necessary to examine the factors that cause stress. These factors, which are also called stressors are as follows (Yurdakoş, 2008: 1):

1. *Physical factors*: ***These are the factors like trauma, severe exercise, noise, heat, humidity, environmental pollution, food restraint, surgical intervention …etc.***
2. **Socio-cultural factors**: These factors are caused by the relationship or conflict between individual and environment.
3. **Psychological factors:** These factors are caused by physical and social factors, or spontaneously. These factors are generally repeated by the individual and can be collected under general topics like disappointment and isolation.

***Physical factors are not in the scope of this study, because the employees that are dismissed are no longer working in that physical environment and so it does not have an effect on stress level of dismissed employees. Instead, two other factors; demographic factors (age, gender, profession, income level, education… etc.) and economical factors (contribution to budget, economical crisis, working areas… etc.) are taken into account.***

***Stress, which was also examined before by the enterprises, increased its importance because of the recent global crisis. Especially the managers and strategists, who have the power of strategic management, should consider how employees are affected by losing their job in an uncertain environment due to the global crisis. The frequency and intensity of stressful events during and after the global crisis is related to the working conditions, individual's characteristics and his/her interaction with social environment (Batıgün and Şahin, 2006:33). Downsizing strategy applications expose many important results on enterprises, employees and social structure. Most of the dismissed employees feel disappointment and severe psychological depression. Some of the effects that are observed on dismissed employees are anger, sadness, jealousy (Allen, 1997:37), disconnection with the social life, alcoholism and drug addiction. In summary, long term and exceeding stress affects the individual's physical and psychological health negatively (Balcı , 2008:1).***

***Losing their job during the downsizing strategy causes some psychological, social and financial effects on employees and their families and also causes some health problems like loss of appetite, nervousness and insomnia (Cunningham, 997:471). Regardless of the reason of downsizing strategy, people who experienced this cannot generally escape from anxiety and stress (Appelbaum, Lebnanc and Shopiro, 1998: 403). It can be effective to take some precautions to compensate the unemployment by social security and social government policies for decreasing the social problems due to the downsizing (Lewis, Frisch, Greenberg, 2004:69).***

The factors that cause stress on dismissed employees should be examined carefully to evaluate the results of downsizing strategy. These factors are age, gender, social support, working period, previous job, financial status, satisfaction from the job, career status, manners during dismissal, amount of indemnity (Zehir and Ceylan, 2002:50), characteristics, perceived life style, future expectations, job opportunities where he/she lives, …etc. These factors can also be examined under the general topics: psychological, socio-cultural, demographic and economical factors.

# METHODOLOGY AND APPLICATION

## Population and Sampling

The main population of this research is formed by the employees who have lost their jobs and became unemployed in Malatya city due to the global crisis in 2008-2009 and registered to İŞKUR Malatya. The number of these people has been increasing gradually. According to the data obtained from İŞKUR Malatya, the number of dismissed people who informed İŞKUR is approximately 2500 by January 2009.

In this research the data was collected by simple random sampling method. The questionnaire forms are sent by mail to the whole population within the scope of this research. We have obtained 336 forms to be evaluated. As we reached to the sufficient answering percentage (0,14) and the results that are obtained by simple random sampling fits to the principle of randomness, it is assumed that a reliable and sufficient sample is realized.

## Data Collecting and Evaluation Method

The questionnaire form, which was prepared as a result of literature survey, was composed of multiple choice and open ended questions, to collect the data from primary source. Then a pilot study is made on related people to test the questionnaire form. The form was revised according to this application by taking the complications and potential risks into account. After the forms were finalized, they were applied to the people who lost their jobs in 2008-2009 and gave their address information to İŞKUR.

The questionnaire form, which was applied via mail, composed of 30 questions. First 5 questions were related to the personal properties of people. The rest 25 questions are about the factors affecting stress level of people who lost their jobs, including socio-cultural, psychological, demographic and economical factors.

In this research 5% error ratio is predicted in the limits of 95% reliability. The questionnaire was filled by 347 people but 11 of them were eliminated due to the lack of sufficient properties. When compared to the main population the ratio of replies are 14%. The reliability results of these data are given in the below Table 1:

**Table 1: Results of Reliability Analysis**

| Questionnaire question groups | Number of Questions | Alpha value |
|---|---|---|
| Socio-cultural factors affecting people's stress level | 8 | ,8834 |
| Psychological factors affecting people's stress level | 6 | ,8274 |
| Demographic factors affecting people's stress level | 5 | ,8480 |
| Economical factors affecting people's stress level | 6 | ,8738 |
| All of the stress factors in the questionnaire | 25 | ,8782 |

As the Alpha value, which is found as a result of reliability analysis, closes to 1, the reliability increases. It is assumed that reliability is high when it is greater than 0,70. When Table 1 is examined, it is seen that all of the reliability percentages belonging to 8 questions related to socio-cultural factors, 6 questions related to psychological factors, 5 questions related to the demographic factors, 6 questions related to economical values and the total 25 questions are considerably high. According to these results, it can be concluded that this survey is a reliable and valid one. The data collected by the survey is evaluated by the program SPSS (Statistical Packages for Social Sciences). These evaluation results are shown by the tables in the next section.

## Distribution of Data and Analysis

The distribution tables due to the characteristics of dismissed people are given in Table 1, Table 2, Table 3, Table 4, Table 5 and Table 6. The distribution related to the factor analysis is given in Table 7.

**Table 2: Distribution of gender**

| Gender | Number | Ratio |
|---|---|---|
| Male | 278 | 0,827 |
| Female | 58 | 0,173 |
| **Total** | **336** | **1.00** |

Approximately 83% of unemployment is formed by male and 17% is formed by female. According to this result we can conclude that most of the unemployed people participate to this survey was male. This result can be accepted as an indicator showing the dominance of male in working life.

**Table 3: Distribution of education level**

| Education Level | Number | Ratio |
|---|---|---|
| Primary School | 128 | 0,381 |
| High School | 181 | 0,539 |
| Vocational High School | 12 | 0,036 |
| Vocational School | 12 | 0,036 |
| University / Master Degree | 3 | 0,008 |
| **Total** | **336** | **1.00** |

When the distribution of education level is examined it is seen that approximately 38% of unemployed people are graduated from primary school, 54% from high school, 3,5 % vocational high school, 3,5 % vocational school and 1% university or beyond. According to these results, primary school and high school graduates form the highest percentage in unemployment. It draws attention to see that the percentage of university graduates is very low. This result is also consistent with the argument saying that the relative well-being of the unskilled workers declines with downsizing (Anwar, 2009: 75-77).

**Table 4: Distribution of Age**

| Age Groups | Number | Ratio |
|---|---|---|
| Between 18-30 | 195 | 0,580 |
| Between 30-40 | 97 | 0,299 |
| Between 40-50 | 35 | 0,104 |
| 50 and older | 6 | 0,018 |
| Missing values | 3 | 0,009 |
| **Total** | **336** | **100** |

The age distribution of people, who has participated this survey, is collected into four groups. It is seen that 58% of unemployment is formed by people whose age is between 18-30. 30% between 30-40, 10,5% between 40-50, and 1,8% older than 50 years old. According to these results, the highest percentage of unemployment is formed by the people who are between 18-30 and 30-40. This might be evaluated that the young workers are the ones who are first dismissed in organizations.

**Table 5: Distribution of position**

| Position | Number | Ratio |
|---|---|---|
| Foreman | 264 | 0,786 |
| Office Personnel | 55 | 0,164 |
| Technical Personnel | 4 | 0,012 |
| Medium Level Manager | 11 | 0,033 |
| Top Level Manager | - | - |
| Missing values | 2 | 0,006 |
| **Total** | **336** | **100** |

The positions are classified into five groups due to the positions that people had when they were working. Almost 78% of the dismissed employees were foreman and 16% were office personnel. The other positions like medium, top level managers and technical personnel form a very small part of unemployment. According to the results, the highest percentage of unemployed people is foreman working in lines. This might be accepted as an indicator of the decrease in production. This result is also consistent with the argument saying that downsizing must be ascribed to declining demand for the relevant products, that is, those that the affected workers were employed in producing (Rinaldi, 2008: 389-409).

**Table 6: Distribution of Experience (in years)**

| Years of Experience | Number | Ratio |
|---|---|---|
| Between 0-5 years working experience | 289 | 0,860 |
| Between 5-10 years working experience | 26 | 0,077 |
| Between 10-15 years working experience | 13 | 0,039 |
| Between 15 years working experience | 6 | 0,018 |
| Missing values | 2 | 0,006 |
| **Total** | **336** | **100** |

The distribution of working experience of people in terms of years is collected into four groups. In this table it is seen that most of the unemployed people have a working experience less than 5 years with a percentage of 86%. 7,7% have an experience of 5-10 years, 3,3% 10-15 years and 1,8% above 15 years. This result might be evaluated that inexperienced workers are the ones who are first dismissed.

**Table 7 Analysis of the Factors Affecting the Stress Level of Dismissed Employees**

| Factor Groups | Factor Weights | Declared Variant | Eigen Value |
|---|---|---|---|
| **FACTOR 1** | | | |
| **Socio-Cultural Variables** | | **%32,68** | **8,17** |
| Aggravation of living conditions gradually | **,962** | | |
| Not keeping up with the professional changes | **,832** | | |
| Decreasing expectations from life | **,833** | | |
| Negative thoughts of environment for himself/herself | **,830** | | |
| Decreasing prestige within the family | **,839** | | |
| Damage of image and authority | **,638** | | |
| Decreasing of responsibility | ,474 | | |
| Discomfort due to the unemployed position | **,799** | | |
| **FACTOR 2** | | | |
| **Psychological Values** | | **%25,79** | **6,44** |
| Anxiety of being dismissed again even if he/she find a new job | ,075 | | |
| Complication of the life style that is perceived and lived | ,134 | | |
| Having a convenient character for stress | **,697** | | |
| The anxiety about having psychological and physiological health problems | **,956** | | |
| Not fulfilling some necessities | **,696** | | |
| Decreasing probability of future expectations | ,488 | | |
| **FACTOR 3** | | | |
| **Demographic Values** | | **%21,84** | **5,46** |
| Decreasing income level | **,878** | | |
| Not having a valid profession | **,860** | | |
| Being affected negatively by being unemployed within his/her age | ,468 | | |
| Having limited job opportunities in his/her living area | **,868** | | |
| Not finding a job due to insufficiency of education | ,441 | | |
| **FACTOR 4** | | | |
| **Economical Values** | | **%10,94** | **2,73** |
| Increasing complications in working life | ,460 | | |
| Decreasing contribution to the family budget | **,895** | | |
| Continuing economical crisis | **,997** | | |
| Insufficiency in solving national economical problems | ,472 | | |
| Rising unemployment and decreasing working areas gradually | **,717** | | |
| Unbalance of labor force due to the excessive supply | ,364 | | |
| ***N*** | ***336*** | | |
| ***KMO Scale*** | ***0,738*** | | |
| ***Bartlett Test*** | ***226,432*** | | |
| ***Total Declared Variance*** | | **%91,25** | |
| ***Significance Level*** | ***0,009*** | | |

Analysis of factors that affect the stress level of people is shown in Table 7. Factor analysis is applied to 336 people in total and KMO measure is found to be 0,738 and Bartlett's test 226,432. As a result of this analysis, 4 basic factors are formed.

**Factor 1: Socio-Cultural Variables:** This factor forms 32,68% of total variance and its Eigen value is 8,17. This factor has the highest effect on people's stress level. The variables which have a close relationship with Factor 1 are: aggravation of living conditions gradually, not keeping up with the professional changes, decreasing expectations from life, negative thought of environment for him/herself, decreasing prestige within the family, damage of image and authority, discomfort due to the unemployed position. The high percentage of these variables can be evaluated as an indicator of the importance of social environment, work life, professional change, friendship and image within the family, for people.

**Factor 2: Psychological Variables:** This factor forms the 25,79% of total variance and its Eigen value is 6,44. This factor has the second highest effect on people's stress level. The variables which have a close relationship with Factor 2 are: having a convenient character for stress, the anxiety about having psychological and physiological health problems and not fulfilling some necessities. It can be seen that the factors included in psychological variable group have an important effect on stress level of people. The high percentage of these variables shows that due to the stress, by also taking the characteristics of people into account, the anxiety about the future might cause complications on psychological and physiological health.

**Factor 3: Demographic Variables:** This factor forms the 21,84% of total variance and its Eigen value is 5,46. This factor has the third highest effect on people's stress level. The variables which have a close relationship with Factor 3 are: decreasing income level, not having a valid profession and having limited job opportunities in his/her living area. The results show that the factors that are listed under demographic variable group also have an important effect on stress level of people.

**Factor 4: Economical Variables:** This factor forms the 10,94% of total variance and its Eigen value is 2,73. This factor has the forth highest effect on people's stress level. The variables which have a close relationship with Factor 4 are: decreasing contribution to the family budget, continuing economical crisis, rising unemployment and decreasing working areas gradually. The results show that the factors that are listed under economical variable group have an important effect on stress level of people. Although this factor forms the source of stress, it is accepted as one of the realities of life due to the economical complications that has been continuing for many years in Turkey. Thus, it can be evaluated that this factor affects the stress level less than others.

# RECOMMENDATIONS and CONCLUSION

The aim of this study was "*to determine and analyze the stress factors on the employees that are dismissed due to the downsizing strategy*". In the theoretical part of this research, downsizing strategy, stress, and the effects of downsizing strategy on stress level of people are examined. As a result of these evaluations it can be concluded that there is a relationship between downsizing strategy and stress level.

In this research, detailed information about people's individual properties like gender, education, age, position and working period is obtained. According to this information, most of the dismissed employees, who are in the scope of this research, are male, graduated from primary or high school and young. Foreman forms the highest percentage of these dismissed employees' working position and their working experience is mostly less than five years. Since the results show that these unemployed people are mostly young, they can be adapted to the working life by increasing their quality by educating them on new and different professions.

When the factors affecting the stress level of dismissed employees are examined, in accordance with the aim of this research, four factor groups can be obtained. These factor groups are composed of socio-cultural, psychological, demographic and economical factors. In this research detailed information about these factor groups are obtained.

It is observed that there is a strong relationship between downsizing strategy and the first factor group: aggravation of living conditions gradually, not keeping up with the professional changes, decreasing expectations from life, negative thought of environment for him/herself, decreasing prestige within the family, damage of image and authority, discomfort due to the unemployed position, which are included in the socio-cultural stress factors. The factors, which are strongly related to the downsizing strategy, in the second factor group (psychological factors) are: having a convenient character for stress, the anxiety about having psychological and physiological health problems and not fulfilling some necessities. In the third factor group which includes the demographic factors, the factors related to the downsizing strategy are: decreasing income level, not having a valid profession and having limited job opportunities in his/her living area. Lastly, in the fourth factor group, including the economical factors like decreasing contribution to the family budget, continuing economical crisis, rising unemployment and decreasing working areas gradually have a strong relationship with the downsizing strategy.

According to the above findings, people care about socio-cultural factors at most. This shows that people give importance to the socio-cultural environment that they are living in, working life, friendship relations and image within their family. In this context, to reduce the effects of social environment on dismissed employees, some activities can be held to educate and make the other people in that society more conscious.

Psychological factors are the second important factor affecting the stress level. These factors are affected by the people's characteristics and they cause anxiety about future and complications of physical and psychological health. In summary, it increases the stress level of people. Psychological supporting services might be helpful to reduce the effects of psychological factors on stress level of dismissed employees.

Demographic factors are the third important factor affecting the stress level. These factors are; decreasing income level, professional insufficiency and having limited job opportunities in his/her living area affect the stress level of dismissed employees. To decrease these effects, unemployment insurance can be paid and vocational education activities can be held.

Economical factors are the fourth important factor affecting the stress level. These factors are; decreasing contribution to the family budget, continuing economical crisis, rising unemployment and decreasing working areas gradually. To reduce the effects of economical factors on stress level of dismissed employees, economical precautions with local differences, unemployment packages, incentive laws and prevention of unregistered employment can be applied.

As a final evaluation, we can say that the research objective is achieved since the stress factors on the employees that are dismissed due to the downsizing strategy and their effects are determined and analyzed.

# REFERENCES

Allen, R.K. (1983), *Human Stress Its Nature and Control*, New York, Mac Millan Publishing Company, USA.

Allen, R.K. (1997), Lean and Mean: Workforce 2000 in America, *Journal of Workplace Learning*, Vol. 9, No:1, pp. 34-42.

Anwar, S. (2009), Wage Inequality, Welfare and Downsizing, *Economic Letters*, Vol:103, No: 2, pp. 75-77.

Appelbaum S.H., Lebnanc M. and Shopiro B.T. (1998), The Aftermath of Downsizing, *Journal of Management Development*, Vol.17, No: 6, pp. 402-431.

Balcı A., *Üniversite Öğretim Elemanlarında İş Stresi Ölçeği*, http://dergiler.ankara.edu.tr/dergiler/40/498/5967.pdf, Erişim Tarihi: 11.10.2008.

Batıgün A.D, Şahin N.H. (2006) İş Stresi ve Sağlık Psikolojisi Araştırmaları İçin İki Ölçek: A-Tipi Kişilik ve İş Doyumu, *Türk Psikiyatri Dergisi*, Cilt 17, Sayı 1, pp. 32-45.

Cunningham, J.B. (1997), Feelings and Interpretations During on Organizations Dealt, *Journal of Organizational Change*, Vol. 10, No: 6, pp. 471-490.

Dahl S., Nesheim T. (1998) Downsizing Strategies and Institutional Environments, *Scandinavian Journal of Management*, Vol. 14, No: 3, pp. 239-257.

Demause K., Bergmann T., Vanderheiden P., Roraff C. (2004), New Evidence Regarding Organizational Downsizing and a Firm's Financial Performance: A Long-term Analysis, *Journal of Managerial Issues*, Vol.16 pp. 155-178.

Dinçer Ö. (1998), *Stratejik Yönetim ve İşletme Politikası*, 5. Baskı, Beta Basım Yayın A.Ş., İstanbul.

Eren E. (2000), *Stratejik Yönetim ve İşletme Politikası*, 5. Baskı, Beta Basım Yayın A.Ş., İstanbul.

Ertekin, Y. (1993), *Stres ve Yönetim*, TODAİ Yayınları, Ankara.

Francis J.D. & Pett T. (2004), Retrenchment in Declining Organizations: Towards an Integrative Understanding, *Journal of Business & Management*, Vol.10, pp. 39-53.

İslamoğlu G. (2002), Başarılı Şirket Küçülmeleri, *Öneri Dergisi*, Cilt.5, Sayı.18, pp. 49-61.

Manson, J.B. (2000), *Downsizing Isuues: The Impact on Employee Morale and Productivity*, Taylor & Francis, U.S.A.

Mccann L, Hassard J, Morris J. (2004), Middle Managers, The New Organizational Ideology and Corporate Restructuring: Comparing Japanese and Anglo-American Management Systems, *Competition and Change*, Vol.8, pp. 27-45.

Jamrog J. (2004), The Perfect Storm: The Future of Retention and Engagement, *Human Resource Planning*, Vol.27, pp. 26-34.

Jiang J. J., Klein G. (2000), Effects of Downsizing Policies on Is Survivors' Attitude and Career Management, *Information & Management*, Vol. 38, No: 1, pp. 25-45.

Lewis D., Frisch M. & Greenberg M (2004), Downsizing and Worker Separations: Modelling the Regional Economic Impacts of Alternative Department of Energy Workforce Adjustment Policies, *Regional Studies*, Vol.38, pp. 67-83.

Rice P. (1999), Stress and Health, Third Edition, Pacific Grove Brooks Cole Publishing, USA.

Rinaldi, G. (2008), "The Size of firm in a Transitional Economy: Downsizing and Economies of Scale: The Case of Russian Footwear", *Economic Systems*, Vol. 32, No: 4, pp. 389-409.
Senturan Ş. (2005) , "İşletmelerde Küçülme Politikalarının İnsan Kaynakları Uygulamaları Üzerindeki Etkileri" Kamu-is, http://www.kamu-is.org.tr/pdf/834.pdf

Ülgen H., Mirze S.K. (2006), *İşletmelerde Stratejik Yönetim*, 3. Baskı, Literatür Yayınları No: 113, Literatür Yayıncılık, İstanbul.

Yurdakoş E., *Stres Fizyolojisi*, http://www.ctf.edu.tr/stek/pdfs/47/4711.pdf, Erişim Tarihi: 05.01.2008

Wager T. (1998). "Exploring The Consequenses of Workforce Reduction", *Canadian Journal of Administrative Sciences*, Vol. 15, pp. 300-309.

Zehir C., Ceylan A. (2002), "Örgütsel Küçülme Stratejilerinin Türkiye'deki Büyük İşletmelerde Çalışanların Tutum ve Davranışlarına Etkileri Üzerinde Bir Araştırrma", *Öneri Dergisi*, Vol. 5, No: 18,pp. 49-61.

# *SUPPLY CHAIN MANAGEMENT & INNOVATION MANAGEMENT*

# AGILE SUPPLY CHAIN: STRATEGY FOR COMPETITIVE ADVANTAGE

**Intaher Marcus Ambe**
**University of South Africa**

## ABSTRACT

*The main objective of this paper is to explore the concept of agile supply chain and to determine the link between agile supply chain and competitive advantage in this challenging and uncertain business world. The 21st century has lead to increase in global competition and customer demands, with higher levels of turbulence and volatility in the market place. Businesses, economics and political environments are increasingly subjected to unexpected shocks and discontinuities. As a result of these uncertainties, organisations today are faced with a number of challenges in the supply chain which include among others the ability to meet up with changes in demand variability, service improvements, lowering inbound costs, improving on-time delivery and shorter customer lead times. In order to survive, companies need to respond to ever-increasing levels of volatility in demand and focus their efforts upon achieving greater agility. Agility has the ability to rapidly respond to changes in market and customer demands as the bearer of competitive advantage. Therefore, companies need to re-design their supply chain to tackle issues of agility in order to stay ahead in a highly competitive global market.*

***Key Words:*** *Agility; Competitive Advantage; Strategy; Supply Chain Management.*

## INTRODUCTION

The turbulent market conditions in the 21st century have heightened the need for more competitive strategies to be developed for growth (Sanchez and Perez, 2007:681). Business, economics and the political environments are increasingly subjected to unexpected shocks and discontinuities. Many strategic issues that confront business today stem from: the new rules of competition, globalisation down pressure on price and the customer taking control. Also, as a result of the recent economic meltdown, companies around the world are confronted by a perfect storm: frozen credit market and long global recession. The world economies are more interconnected and symbiotic than one really cannot understands. Events are moving so rapidly that it is almost impossible to access the implication of the meltdown for the days ahead, let alone the years to come.

Currently, the world is in the era of supply chain competition, where organisation no longer acts in isolation as an independent entity, but as a supply chain to create value delivery systems that are more responsive to fast-changing markets, more consistent and reliable (Christopher, 2005:29). The core capabilities of a company lie in its ability to design and manage its supply chain in order to gain maximum advantage in the market where competitive forces are changing. New managerial practices and unique business models emerge and fade constantly as managers strive to help their companies succeed in this less-kind, less gentle and less predictable world (Fawcett, Ellram and Ogden, 2007). The best word to describe the global market today is volatility. Organisations have to develop strategies in order to respond to ever-increasing levels of volatility in demand. The big question is: How are supply chain executives coping with the changing business environment and what strategy can be implemented to achieve competitive advantage in their supply chain? Agility has the ability to rapidly respond to changes in market and customer demands as the bearer of competitive advantage. Despite the obvious benefits of agility, organisations are faced with challenges in implementing the measures necessary to increase their agility (Prater, Biehl and Smith, 2001). The paper explores the concept of agile supply chain and competitive advantage and presents a framework on the linkage between agile supply chain and competitive advantage.

## SUPPLY CHAIN MANAGEMENT

Supply chain management can be defined as, " the systems approach to managing the entire flow of information, materials and services from the raw materials suppliers through factories and warehouses to the end customer" Leenders and Fearon (1997: 295). It is the management of upstream and downstream relationships with suppliers and customers to deliver superior customer value at less cost to the supply chain as a whole Christopher (2005:5). Supply chain links suppliers and customers from the extraction of raw materials until the product reaches the ultimate end user. A supply chain therefore comprises a physical element and the information element. It can be viewed as the formation of a value chain network consisting of individual functional entities committed to the controlled sharing of business data, processes and provides a framework for the movement of raw materials through manufacturing and distribution to the end customer. (Lau & Lee 2000:598). Supply chain management exist in all organisational types in varying degrees and can be classified into three categories: a management philosophy, implementation of a management philosophy, and as a set of management processes (Mentzer, 2001:8).

Supply chain management is about competing on value, collaborating with customers and suppliers to create a position of strength in the marketplace based on value derived from end consumer needs. The overall objectives of supply chain management is to create value for customers, competitive advantage and improved profitability for supply chain firms, the dimensions of value that may be important to customers, and the mechanisms whereby competitive advantage and improved profitability can be achieved. Within an organisation, customer value is created through collaboration and cooperation to improve efficiency (lower cost) or market effectiveness (added benefits) in ways that are most valuable to key customers. Value is not inherent in products or services, but rather is perceived or experienced by the customer. Therefore, in order to compete through creating customer value, a firm must understand, and deliver the value perceived as important by its customers. By satisfying customers and achieving competitive advantage, firms in a supply chain influence customers to make choices and behave in ways that improve the financial performance of the supply chain and the firms within it.

## Issues to Ponder within Supply Chain Management

SCM encompasses planning, manufacturing and operations management necessary to bring a product to the market place, from the sourcing of materials to the delivery of the completed product. The following are some of the issues to consider when developing or managing a supply chain:

**Supply Chain Integration:** Supply chain integration is process integration upstream and downstream in the supply chain (Iskanius, 2006:84). It refers to a formation of network encompassing elements of supply chain, which are the suppliers, customers and the company. It is a competitive strategy used by companies to achieve greater coordination and collaboration among supply chain partners. The basic components of integration are cooperation, collaboration, information sharing, trust, partnership and shared technology.

**Information Technology and Information Management:** The advent of the Internet and electronic communication has enabled companies to be more responsive to their customers than ever. The management of information technology is an important facilitator of supply chain integration because of its capability to surmount both time and distance constraints. Information is a key ingredient not just at every stage of a supply chain, but also within each phase of supply chain decision-making from the strategic phase to the planning phase to the operational phase (Chopra & Meindl 2001).

**Supply Chain Collaboration:** Supply chain collaboration facilitates the cooperation of participating members along the supply chain to improve performance (Bowersox, 1990). The benefits of collaboration include revenue enhancements, cost reductions, and operational flexibility to cope with high demand uncertainties (Fisher, 1997; Lee *et al.*, 1997). The driving force of effective SCM is collaboration. Strategic SCM demands collaboration among all participants in the value chain, whatever their size, function, or relative position. You cannot optimize your own operations until you understand the real-time demands of your customers' customers as well as the current constraints for your suppliers' suppliers. It is the ability to apprehend and respond to the changing needs of customers far down the demand chain that produces such strategic benefits as improved project design and more effective marketing. The order of magnitude increases in levels of collaboration and information sharing associated with SCM will demand a new form of collaborative technology infrastructure.

**Customer - Supplier Relationship Management:** Information sharing, collaboration, cross-organisational team development and strategic partnering form the foundation on which supply chain design and integration are achieved. It is essential that an organisation collaborate and manage it relationships between the customers and the suppliers. In competitive environment, customer satisfaction is absolute for staying abreast. This can be achieved only by quickly responding to customer needs. Efficient consumer response (ECR) is a SCM strategy that attempts to address the inefficiencies in the supply chain.

**Supply chain Design:** Manufacturing firm's supply chain design is based on effective integration. Most of the practices about supply chain design have concentrated mostly in the manufacturing functions (Borade and Nansod, 2007:112). Integration is the essence of SCM. The challenges of design a supply chain is to determine the structure of organization, roles and responsibilities, as well as finding the right people with the right skills. Supply chain organisation, as any other organization, evolves constantly. Depending on changed business requirements or identified improvement initiatives; the roles and responsibilities might change, as well as goals and priorities.

**Logistics and Distribution Management:** Logistics refers to the inbound and outbound flow and storage of goods, services, and information within and between organisations. Accroding to Mclvor, (2003:380) logistics can be defined as "the process of strategically managing the procurement, movement and storage of materials, parts and finished inventory and related information flow through the organization and its marketing channels" It is the creation of time, place, quantity, form and possession utilities within and among firms and individuals through strategic management, infrastructure management and resource management in order to create products/services that satisfy customers through the attainment of value.

**Outsourcing and Global Issues:** Outsourcing is the transfer or sharing of management control and or decision-making function to an outside supplier. It is the process of contracting out services with the intention to minimise costs. It provides a degree of two-way information exchange, coordination and trust between the outsourcer and its client, involves the use of specialists to provide competence, technologies and resources to parts of the whole (Jefferies, 1996:26; Harland, branchley & Walker, 2003).

**Partnerships:** As global markets grow increasingly efficient, competition no longer takes place between individual businesses, but between entire value chains. Therefore supply chain practitioners should develop supply chain partnerships/collaboration in an attempt to reduce costs, improve service and to gain competitive advantage. Collaboration requires individual participants to adopt simplified, standardized solutions based on common architectures and data models. Horvath (2001) proposed that Collaboration through intelligent e-business networks would provide the competitive edge to all the participants in a value chain to prevail and grow. Collaborative partnerships can be achieved both via trust and through electronically mediated exchange.

**Performance Measurement:** The pace of globalisation and the nature of competition have forced organizations to monitor their performance of their competitors. One of the keys to gaining competitive advantage lies in configuring a supply chain that ensures better material flow at lower costs and with superior customer service. Performance measurement and improvement are very important to overall business success and should not be neglected. A supply chain measurement and improvement system should clearly indicate what has to be measured. One model that is widely used in measuring the performance of the supply chain is the balanced scorecard of Kaplan and Norton (1992; 1996).

**Social and Environmental issues:** Because of the complexity and uncertainty of economical, environmental and social corporate developments, there is a need for companies to create flexible solutions to the operative integration of additional supplier requirements during their business processes. Environmental standards can be defined as quantitative specifications to limit different kinds of anthropogenic impacts on human beings and/or the environment. Social standards include accepted rules for designing labour relations, working conditions, and social safety systems. There is a huge variety of associated terms ranging from working conventions to social provision to cachets and codes of behaviour (Pallmann 2002). The integration and implementation of standards for a special business process, a company normally tracks one of the following objectives: consumer protection and transparency on the market, environmental protection, or safety at work. The compliance of vendors cannot be monitored and ensured by analysing the supplied products in comparison to product standards like quality. Therefore it is necessary to combine the normative content level as embedded in supply policies of environmental and social standards and the purchasing process, which includes supplier evaluation and selection, as well as monitoring, combined with supplier qualification.

## Supply Chain Strategies

By definition, supply chain management demands a high level of 'joined-up thinking'. That is the selection of suppliers, the location of facilities and the choice of distribution channels should all be driven by the goal of enabling the marketing objectives of the organisation to be achieved. A typical supply chain strategy should be aimed at achieving a smooth flow at minimum cost (Harrington, 1991 and Scott and Westbrook, 1991). But what are the right supply chain decisions to be made that will enable an organisation to define its business and ensure that its marketing strategy is enacted? How does the in-sourcing/out-sourcing option fit into the holistic scheme of things? Is there a taxonomy which executive management can use with confidence to establish not only the type, but the number of segmented supply chain strategies required to achieve competitive advantage? (Christpher, Peck and Towill, 2006: 3). It is now increasingly accepted that "one size does not fit all" when it comes to designing supply chain strategies to support a wide range of products with different characteristics sold in a diversity of markets (Shewchuck, 1998). Supply chain strategies should be tailored to match the required 'order winning criteria' in the market place. Aligning the firm's operations with market place requirements has not always been extended to the wider supply chain. An organisation's sourcing strategy, operations strategy and route-to-market need to be appropriate to specific product/market condition (Hill, 1985). Because today, it is supply chains that compete and not companies, it is important to create a holistic supply chain environment. The fundamental changes in the environment of global competition and trends such as outsourcing require organisations to develop supply chain strategies that are aligned to "appropriate value propositions" and customer market segments. The major generic strategies in supply chain are lean and agility. "*Agility* means using market knowledge and a virtual corporation to exploit profitable opportunities in a volatile marketplace" where as "*Leanness* means developing a value stream to eliminate all waste including time, and to enable a level schedule."

## Lean vs Agile Supply Chain

The concept of agile supply chains was introduced to transfer and apply the winning strategy of agility to that of supply chains (Harrison et al., 1999). It is a newly accepted unit of business. Agility in the context of supply chain management focuses on "responsiveness" (Lee and Lau, 1999; Christopher and Towill, 2000). Existing literature on agility presents it as a general concept, often linked to manufacturing only (Maskell, 2001). A supply chain provides more practical setting for assessing agile capabilities (van Hoek et al., 2001). It is unlikely that any single organisation will be able to produce artifacts with correctly configured customization and added value to satisfy a particular emergent market demand. Agility suggests cooperation to enhance competitiveness within organisations Several authors claim that it is difficult to estimate agility directly in the supply chain (Christopher, 2000; van Hoek et al., 2001; Sharifi and Zhang, 1999). In order to reduce this significant deficiency, the supply chain is frequently introduced as an area where the agility concept can be applied in operations. The key elements of an agile approach are very similar to the elements of the agile supply chain. Agility is all about customer responsiveness, people and information, cooperation within and between firms and fitting a company for change. To be truly agile, a supply chain must possess a number of distinguishing characteristics which include: market sensitivity, virtuality, process integration, and networking (Kisperska-Moron and Swiercze, 2008: 2). Parallel developments in the areas of agility and supply chain management led to the introduction of an agile supply chain (Harrison et al. 1999, Christopher 2000). While agility is accepted widely as a winning strategy for growth, even a basis for survival in certain business environments, the idea of creating agile supply chains has become a logical step for companies (Ismail & Sharifi 2005). Agility in a supply chain is the ability of the supply chain as a whole and its members to rapidly align the network and its operations to dynamic and turbulent requirements of the customers. The main focus is on running businesses in network structures with an adequate level of agility to respond to changes as well as proactively anticipate changes and seek new emerging opportunities.

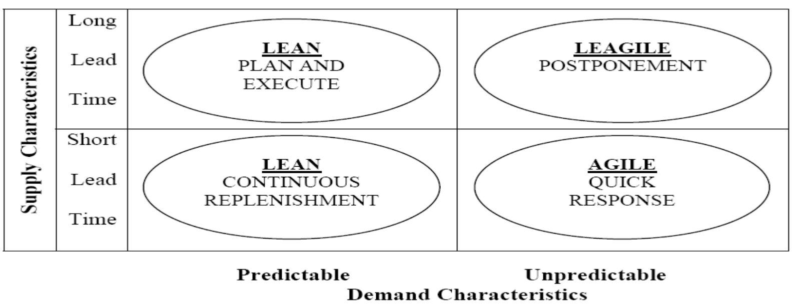
With the increase in competition and companies wooing the customer, agile supply chain has emerged as the new mantra. Those who can meet customer demands are more successful. With consumer preferences changing fast it became even more important to bring in new products at a pace that would put a supersonic to shame. But doesn't this pace fly in the face of global supply chains that thrive on "best price" sourcing? To some extent yes. No longer is the customer willing to wait three months to wear her fashion (cloths) that is made and exported from a country thousands of miles away. Fashion considerations now rule the day: if the product for example a dress is to be worn, its time is now, before everyone else is wearing it. '*Lean*' works best in a high volume, low variety and predictable environments, whereas '*Agility*' is needed in a less predictable environment where the demand for variety is high**.** What about factories that have been specifically built to achieve economies of scale? Are they helping their cause? Every single organisation (manufacturing) that wants to maximize economies of scale will find itself struggling when that customer comes knocking to place orders and wants quick response for its products.

So when should an organisation have agility? Typical products that qualify for this consideration are electronics and fashion items. These products are sold for their "distinctive" appeal and not really for the function they perform. They have short life cycles and shorter shelf lives. Demand for these products is difficult to forecast and stock-out rates can be astronomic. In some situation, they may exists the need for both lean and agile supply chain solution since some products will have predictable demand whilst for others, the demand will be far more volatile. Identifying the types of supply chain strategies might be appropriate in different circumstances to position the product in an organization's portfolio according to their supply and demand characteristics. Supply characteristics include: the lead time of replenishment and it is clear that different supply chain strategy will be employed when lead times are shorter than when they are longer. With shorter lead times, there is a rush to make everything distinct in today's global marketplace, from biscuits to Barbie dolls. Commoditization is diminishing with each passing day. Markets are reorganizing from mass markets into highly fragmented niche markets.

So is lean dead? Hardly, it exists for "functional" products, those used for our basic needs (such as food). These products have predictable demand and hence are easier to forecast. The stock-out rates are negligible. The predictable demand of lean supply chain makes the tasks easier for companies as they can focus on one prime goal: Cost reduction. Sophisticated systems and processes ensure that technology plays the required role in meeting this goal. Inventory is minimized and efficiency throughout the supply chain is maximized to get the desired results. All upstream and downstream functions collaborate to make sure that the predicted demand numbers are met at the minimum cost possible.

Christopher and Towill (2002:9) suggested four broad generic supply chains strategies dependent upon the combination of supply and demand conditions for each product. These demand conditions might be characterized by predictability of demand as shown in figure 1.

**Figure 1: Demand and Supply Characteristics**




**[Source:** Christopher and Towill (2002:9)]

The demand characteristics in terms of 'predictability' determine the variability of demand. Selecting a strategic approach (lean or agile) in a supply chain can be complex. Intelligent supply chains throughout the world use a combination of lean and agile for their benefit. Table 1 shows some of the attributes that distinguishes lean and agile supply.

**Table 1: Attributes of Lean and Agile Supply**

| DISTINGUISHING ATTRIBUTES | LEAN SUPPLY | AGILE SUPPLY |
|---|---|---|
| Typical Products | Commodities | Fashion Goods |
| Marketplace Demand | Predictable | Volatile |
| Product Variety | Low | High |
| Product Life Cycle | Long | Short |
| Customer Drivers | Cost | Availability |
| Profit Margin | Low | High |
| Dominant Costs | Physical Costs | Marketability |
| Stockout Penalties | Long Term Contractual | Immediate and Volatile |
| Purchasing Policy | Buy Goods | Assign Capacity |
| Information Enrichment | Highly Desirable | Obligatory |
| Forecasting mechanism | Algorithmic | Consultative |

[**Source:** Manson-Jones, Naylor and (2000)]

Supply chain performance improvement initiatives should be focused on matching supply to demand thereby driving down costs simultaneously with improving customer satisfaction. This invariably requires uncertainty within the supply chain to be reduced as much as practicable so as to facilitate a more predictable upstream demand (Mason-Jones et al., 1999). Specific supply chains are faced with the situation where they have to accept uncertainty but need to develop a strategy that enables them to still match supply and demand. One way to distinguish between supply chains strategies is through the product types for which each strategy is used. Fisher, (1997), classified products into two generic types, fashion and commodities as follows:

- **Fashion products:** They have a short life cycle and high demand uncertainty, therefore exposing the supply chain to the risks of both stock out and obsolescence. A good example of a fashion product is trendy clothing. The challenge faced by a supply chain delivering fashion products is to develop a strategy that will improve the match between supply and demand and enable the companies to respond faster to the marketplace. Agile supply chains are typically used for fashion products.
- **Commodities**: These are basic products, such as tinned soups, have relatively long life cycles and have low demand uncertainty due to the fact they tend to be well-established products with a known consumption pattern. The driving force for basic product supply chains is therefore cost reduction. Lean supply chains are typically used for commodities.

When you know your supply chain strategy, it is important to determine the market Winners and market Qualifiers for its products. According to Hill (1993) there is a considerable difference between the two groups of products ('order qualifiers' and 'order winners') against which manufacturing strategies should be determined. Every business needs to understand what the baseline is for entering into the competitive arena (the order qualifiers). Order Qualifiers are those (minimum) criteria that a company must meet to be considered as a possible supplier while order winners are those criteria that win the orders. The definition of order qualifiers and order winners logically leads to the specification of the appropriate manufacturing strategy. It is on this basis that the concept of 'market qualifiers' and 'market winners' developed (Christopher and Towill, 2002). Table 2 depicts a framework for market winners and market qualifiers.

**Table 2: Market Winners and market Qualifiers**

| | | |
|---|---|---|
| **Fashion Goods (Agile Characteristics)** | · **Quality**<br>· **Price**<br>· **Lead Time** | • **Service Level** |
| **Commodities (Lean Characteristics)** | · **Quality**<br>· **Lead Time**<br>· **Service Level** | • **Price** |
| | **Market Qualifiers** | **Market Winners** |

[**Source:** Adapted from Manson-Jones et al., (2000: 4046)**]**

The market winner for fashion products is availability, whereas the market winner for commodities is price. Quality and lead-time are market qualifiers in both cases: price and availability are market qualifiers for fashion products and commodities respectively. The emphasis on the figure is that supply chain must excel at the market winner metrics *and* be highly competitive at the market qualifier metrics that is the minimum standard for entry into the marketplace. These two product types respond to distinctly different marketplace pressures and hence require a different supply chain approach to address their specific characteristics. Understanding the particular characteristics of the product type, marketplace requirements and management challenges, will help an organisation to design the correct supply chain strategy that will ensure optimal performance and gain competitive advantage. This can be achieved via developing strategies that will reduce the effect of the system-induced uncertainty, thereby reducing the Bullwhip effect and, at the same time, actively coping with the particular marketplace uncertainty pressures.

Looking at the different characteristics, there are different ways that an organisation can integrate lean and agile supply chain. Based on the attributes of lean and agile supply chain, it is evident that a number of common characteristics exist and the whole concept can co-exist (Aitken, 2001). There are three ways in which Leanness and agility can sometimes be combined. That is through the strategic use the perato curve approach, the decoupling point and the 'base and surge' demands (Christopher, 2005). Therefore, instead of a "pure" agile and pure lean supply chain, there will often be situations where a combination of the two may be appropriate, i.e. a hybrid strategy, that is, a mixed portfolio of products and markets, there will be some products, where demand is stable and predictable, and some products where the converse is true. As Fisher (1997) points out, it is important that the characteristics of demand are recognized in the design of supply chains. Also, it is not necessarily that a supply chain should be either lean or agile. Instead, a supply chain may need to be lean for part of the time and agile for the rest. Naylor *et al.* (1999) and Mason-Jones *et al.* (2000) present the term "*leagility*" - the combination of the lean and agile paradigm within a total supply chain strategy positioning the decoupling point, so as to best suit the need for responding to a volatile demand downstream yet providing level scheduling upstream from the decoupling point.

## COMPETITIVE ADVANTAGE IN THE SUPPLY CHAIN

Competitive advantage exists when a firm has a product or service that is perceived by its target market customers as better than that of its competitors. It is an advantage an organisation has over competitors, gained by offering consumers greater value, either by means of lower prices or by providing greater benefits and service that justifies higher prices. SCM is about competing on value, collaborating with customers and suppliers to create a position of strength in the marketplace based on value derived from end consumer. The overall objectives of SCM is to create value for customers, competitive advantage and improved profitability for supply chain firms, the dimensions of value that may be important to customers, and the mechanisms whereby competitive advantage and improved profitability can be achieved. Within an organisation, customer value is created through collaboration and cooperation to improve efficiency (lower cost) or market effectiveness (added benefits) in ways that are most valuable to key customers. Value is not inherent in products or services, but rather is perceived or experienced by the customer. Therefore, in order to compete through creating customer value, a firm must understand, and deliver the value perceived as important by its customers. By satisfying customers and achieving competitive advantage, firms in a supply chain influence customers to make choices and behave in ways that improve the financial performance of the supply chain and the firms within it.

An organisation's competitive advantage is built upon a well-planned and executed supply chain management strategy that is sustainable (Gourdin 2001). This is because it is broadly considered as a philosophy of management. Supply chain management is never totally attained by any company or group of companies, nor can the elements of success enjoyed by one supply network be transferred to another with the expectation of identical levels of performance. Therefore, competitive advantage belong to those supply chains that can activate concurrent business processes and core competences that merge infrastructures, share risks and costs, leverage the shortness of today's product lifecycle, reduce time to market, and gain and anticipate new vistas for competitive leadership (Ross 1998.) In the competitive context, successful companies either have a productivity advantage (or cost advantage) or value advantage, or ideally, a combination of these two (Christopher 1998, McKinnon 2001). A supply chain is a part of an organisation's competitive advantage. No producer is an island nor can any organization work independently from its supply chain. Every organization works in teams or supply chains. So if any part of the chain is weak then the whole business model becomes weak. Wastes and inefficiencies that cannot be passed on to the customer result in costs and low profits for the producer – an uncompetitive position. In basic terms, the supply chain consists of your suppliers, your customers and, the producer. Competitive advantage can be achieved by aligning the supply chain strategy to the competitive strategy.

## Competitive Strategies

A firm's relative position within an industry is given by its choice of *competitive advantage* (cost leadership vs. differentiation) and its choice of *competitive scope*. Competitive scope distinguishes between firms targeting broad industry segments and firms focusing on a narrow segment. Generic strategies (Porter, 1995:12) are useful because they characterize strategic positions at *the simplest and broadest level*. Porter (1995) maintains that achieving competitive advantage requires a firm to make a choice about the type and scope of its competitive advantage. There are different risks inherent in each generic strategy, but being "all things to all people" is a sure recipe for mediocrity - getting "stuck in the middle". Therefore an organization can create competitive advantage through:

- **Cost Leadership:** Cost advantage occurs when an organization delivers the same services as its competitors at a lower cost.
- **Differentiation:** Differentiation advantage occurs when an organization delivers greater services for the same price of its competitors. They are collectively known as positional advantages because they denote the firm’s position in its industry as a leader in either superior services or cost.
- **Focus:** A focused approach requires a fir, to concentrate on a narrow rather than industry wide competitive advantage.

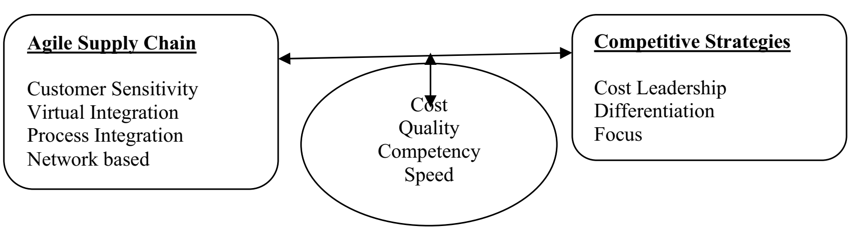
The attributes of cost leadership and differentiation is shown in table 3.

**Table 3: Attributes of Cost Leadership and Differentiation**

| Cost Leadership | Differentiation |
|---|---|
| • efficiency | • effectiveness |
| • standardization | • customization |
| • mass production | • shorter production runs |
| • process improvement | • product development |
| • reduced service | • enhanced service |
| • stability | • flexibility |
| • cost accounting skill | • strong marketing |

Based on the attributes of exhibit 4, there is a linkage between agile supply chain and the competitive strategies. Agile supply chain response rapidly to changes in the business environment, align with the firm’s competitive strategy to improve competitive performance, hence gain competitive advantage. The bottom line is the cost minimisation, improved quality product/services, gain competency and increase speed. This is illustrated in figure 2 below.

**Figure 2: the Link between Agile Supply Chain and Competitive Strategies**




## FRAMEWORK FOR ALIGNING AGILE SUPPLY CHAIN TO COMPETITIVE ADVANTAGE

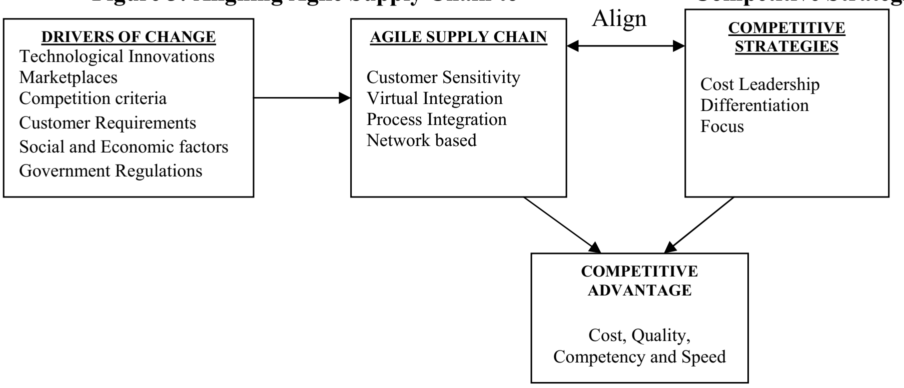
The aim of the proposed framework is to map the link between agile supply chain and competitive advantage. In this turbulent uncertainty in the business environment, it is important to determine your market, the nature of products and services, the market winners and market qualifiers to determine your supply chain strategy. As indicated in the paper, the best supply chain strategy to use to meet customer expectation when demand is uncertainty is agile supply chain. In an uncertain business environment, competitive advantage is achieved when you determine the drivers of change, be flexible, adaptive and responsive through agile supply chain strategy; and align your supply chain strategy to the overall business strategy to gain competitive advantage as explain below.

**Drivers of Change:** The main driving force behind agility is change. It is changes or pressures in a business environment that force a company to search for new ways of running its business in order to maintain its competitive advantage. The change drivers can be characterized by the following elements: changes in marketplace; changes in customer requirements; changes in competition criteria; changes in technology; as well as changes in social factors (Zhang and Sharifi 2001:1). When a business venture is faced with rapid changes, agility supply chain strategy should be employed to respond quickly to counter act the effect of the changes to gain competitive advantage.

**Agile Supply Chain:** An agile supply chain requires various distinguishing capabilities in order to enrich and satisfy customers. These include: responsiveness, flexibility and adaptability. To be truly agile, an organisation must possess the following elements: market sensitive, process integration, network based and virtual (van Hoek, 2001; Christopher, 2000). They should be able to be flexible, responsive and adapt to changing market conditions. This can be achieved through collaborative relationship, process integration, information integration, and customer/marketing sensitivity achieving customer-satisfied objectives. These include cost, time, competency and speed in the supply chain contributing to competitive advantage of the entire organisation.

**Competitive Advantage:** An organisation's position in the industry in which it operates is determined by its competitive strategy. A winning competitive strategy is founded on consistently understanding and predicting changing market conditions and customer needs. Agile supply chain must be aligned to the competitive strategies to improve the overall performance of the organisation. The target of agile supply chain is to provide personalized products with unique features to the market quickly in order to maintain a competitive advantage in today's changing environment. In order to fulfill such a target, the supply chain may maintain a substantive stock of components waiting for the final assembly or configuration. That is a converse method to the lean supply chain that is a cost-advantage strategy. Goldman et al. (1995) contended that the market segmentation is a major force for introducing and implementing agility in an organization. Through the share of market knowledge and competencies of partners, the agile supply chain can make detail market segmentation and introduce new product more quickly. Porter's differentiation strategy refers to the unique image or value of products and services. In the context of supply chain management, the agile supply chain is the most appropriate format to fulfill the specific goal of Porter's differentiation strategies and is appropriate to meet the challenges of the business environment. If you know you supply chain strategy and your competitive strategy based on the product and the customers, aligning the two strategies will lead to competitive performance in the organization. Figure 3 below shows the framework for agile supply chain as a strategy for competitive advantage.

**Figure 3: Aligning Agile Supply Chain to Competitive Strategies**




# CONCLUSION

The main objective of the paper was to explore the concept of agile supply chain and to determine the link between agile supply chain and competitive advantage. Based on literature explored, because agile supply chain is a winning strategy for growth, and lean supply chain a pre-requisite for the creation of an agile supply chain, it is evident that it is a strategy for competitive advantage. Agile supply chain is triggered by"change"which is the only constant thing in the business environment. Furthermore, relevant literature has shown that business success can only be achieved through effective co-ordination of all the participants companies across the supply chain (Van Hoek et al, 2001) to shorten product life cycle and reduce product cost (Levary, 2000) as supply fluctuates more rapidly than ever before. Breaking through this challenge, it is necessary that organizations focus their effort upon achieving greater agility such that it can respond in shorter time frames both in terms of volume change and variety change (Christopher, 2005). Agility is considered as a vital factor for business success in complex industrial landscapes as it enables rival firms to efficiently perform under time-to-market pressures. Putting the idea of lean and agile supply chain together, it can be concluded that lean is needed to build agility and the pre-requisite for success in the market place is an agile supply chain. The key to the success of an organisation is to align agile supply chain strategy to the differentiation strategy to meet the overall objective for competitive performance, hence competitive advantage. Therefore, agile supply chain is a strategy for competitive advantage. If you're not agile, you can't do it, because customer expectations are never static.

Therefore, to sustain and maintain supply chain agility, an organisation should:

- Commit to flexibility and adaptability in regards to your supply chain. Convince those who will implement the necessary programs of its importance.
- Identify the factors involved in past problems with your company's supply chain. Review your business's past history for its biggest problems.
- Implement simple solutions for these problems.
- Design programs for solutions that are not solved simply. Prioritize problems on the basis of which are most likely. Systematically move through these problems.
- Address flexibility and adaptability while moving through the later stages of disaster-proofing your production. Begin by asking for input from all levels of production, even levels below that of managers.
- Centralize responsibility for reviewing plans for change. Those with the responsibility should have a broad base of experience. Involve consulting firms if needed, but critically assess the skills of the consultants such that they fit into your team.
- Integrate the newer theories of agile supply chains, specifically those that allow for greater coordination between customers and suppliers, where appropriate.

# REFERNCES


Christopher, M., (2005), “Logistics and Supply Chain Management- Creating Value-Adding Networks,” Prentice Hall/ Financial Times.

Childerhouse, P., Disney, S. and Towill, D.R., (2000), “Speeding up the Progress Curve towards Effective Supply Chain Management”, International Journal of Supply Chain Management’, Vol 5, No. 3, pp 176-186.

Christopher M., (1998), Logistics and Supply Chain Management – Strategies for Reducing Cost and Improving Service, Prentice-Hall.

Christopher, M., (2000), “The Agile Supply Chain: Competing in Volatile Markets”, Ind. Mark. Man., Vol 29, No. 1, pp 37-44.

Christopher, M. and Towill, D.R., (2000), “Supply Chain Migration from Lean and Functional to Agile and Customised”, Int. Jnl. Sup. Ch. Man, 5(4), pp 206-213.

Christopher, M. and Towill, D.R. (2002), “Developing Market Specific Supply Chain Strategies”, *International Journal of Logistics Management*, Vol. 13, No. 1, pp. 1-14.

Fawcet, SE, Ellram, LM and Ogden, JA, (2007), Supply Chain Management: From Vision to Implementation. Upper Saddle River, New jersey: Prentice hall.

Fisher, M., (1997), “What is the Right Supply Chain for your Product?”, Harvard Business Review, March/April.

Goldman, S.L., Nagel, R.N. and Preiss, K., (1995), Agile competitors and virtual organisations: Strategies for enriching the customer. New York: Van Nostrand Reinhold.

Gourdin, K. N., (2001), Global Logistics Management:A competitive advantage for the new
Harrison, A., Christopher, M and van Hoek, R., (1999), “Creating the agile supply chain”, working paper, School of Management, Cranfield University.

Hill, T. (1993), Manufacturing Strategy : Text and Cases, Second Edition, MacMillan Press, London.

Ismail, HS and Sharifi, H., (2005),”Supply chain design and design for supply chain: a balanced approach to building agile supply chains”, proceedings of ICAM 2005, Helsinki, July.

Leenders, M.R & Fearon, H.E., (1997), Purchasing and supply chain management Chicago: Irwin, (11th ed).

Lee, W.B., Lau, H.C.W., (1999). Factory on demand: The shaping of an agile network. International Journal of Agile Manufacturing Systems 1/2, 83–87.

Mason-Jones R & Towill DR (1999) Total cycle time compression and the agile supply chain. International Journal of Production Economics 62: 61–73.
Mason-Jones, R., Naylor, J.B., and Towill, D. (2000), “Engineering the Leagile Supply Chain”, to be published, Int. Jnl. Agile Man. Systems.

McKinnon A (2001), In: Brewer AM, Button KJ & Hensher DA (eds) Handbook of Logistics and Supply-Chain Management. Pergamon, 157–170.

Mentzer, J. T., Ed., (2001), Supply Chain Management. Thousand Oaks, Sage Publications’, Inc.

Porter, Michael E., (1980), *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (London: Free Press), ISBN 0-02-925360-8

Porter ME (1985) Competitive Advantage. The Free Press.

Ross D.F., (1998), Competing Through Supply Chain Management. Creating Market-Winning Strategies through Supply.

Van Hoek, R.I., Harrison, A., Christopher, M., (2001), Measuring agile capabilities in the supply chain. International Journal of Operations and Production Management 21 (1/2), 126–147.

# THE USAGE OF RFID (RADIO FREQUENCY IDENTIFICATION) IN SUPPLY CHAIN MANAGEMENT

**Esra Erzengin**
**Serdar Alnıpak**
**Metin Uyar**
**Sudi Apak,**

**Beykent University, Turkey**

## ABSTRACT

Radio frequency identification (RFID) is one of the most promising and anticipated technologies in recent years. With the use of RFID, the efficiency of Supply Chain Management can be improved because this technology can give visibility to the supply chains. Such visibility saves labor cost, improves supply chain coordination, reduces inventory, and increases product availability. This article aims to explain what RFID is and how it works. The article also describes the usage of RFID in supply chains, highlights the benefits and limitations of RFID in terms of strategic management and gives cases from the firms which used this technology and gained competitive advantage.

## INTRODUCTION

RFID (radio frequency identification) is an automatic identification and data capture technology that has been around for decades and could be evolved from World War II (Shih, Chiu, Chang and Yen, 2008). It is a promising and already rapidly emerging technology and gained attention in recent years as a means of enhancing data handling processes, which offers greater precision, flexibility, and potential cost savings and has attracted the interest of businesses and public entities (Shih, Chiu, Chang and Yen, 2008).

Even though RFID technology has initially been developed decades ago, the use of RFID in large-scale supply chain operations has until now been prohibited due to the relatively high costs compared to other Auto-ID solutions. Recent studies on the integration issues of the technology reveal that there are still several technical, as well as rather political, barriers to be solved before widespread RFID deployment in supply chain operations can take place (Rochel, 2007).

## 1. HOW RFID WORKS?

Radio frequency identification (RFID) is a small tag containing an integrated circuit chip and an antenna, and has the ability to respond to radio waves transmitted from the RFID reader in order to send, process, and store information. The RFID system consists of three basic components: a tag, a reader, and back office dataprocessing equipment (Wu, Nystrom, Lin, and Yu, 2006). A tag (also known as a transponder) consists of a microchip that stores identification data of the item to which it is attached and an antenna to transmit this data via radio waves. RFID tags can be further categorized as active or passive. Generally of the read/write type, active tags are powered by an internal battery source, have a longer reading range, and are used in applications in which the reader cannot be located close to the tag, as in electronic toll collection. They are larger, heavier, and more expensive than passive tags, and last for about ten years. Passive tags draw power from the readers. Lighter, smaller, and cheaper to produce, they can last for a long time and usually operate in close reading range—from a fraction of an inch to a few feet (Srivastava, 2004).

RFID technology works on a number of frequency bands. Low-frequency tags are used in applications where the range is generally less than 10 inches (tracking work-inprocess inventory, access control), while high-frequency tags are used in areas of a few feet (smart cards). Ultrahigh-frequency tags are used in applications such as toll payment in which high-speed reading is vital and the distances can run to several feet. Generally, as the frequency goes up, both tags and readers become more expensive (Srivastava 2004).

A reader (also known as an interrogator) sends out a radio signal and prompts the tag to broadcast the data contained on its chip. The reader then converts the radio waves returned from the tag into digital data and forwards them to a computer system. A reader can scan an area for any tags that are tuned to the same frequency as the reader. (Tajima, 2007). The antenna emits signals in order to activate the tag and read or write data to it. Each system contains at least one antenna, sometimes two. Indeed one antenna transmits and one antenna receives the signal, in some systems, one antenna can do both those two applications (Moreau, 2003). Back office dataprocessing equipment can be as simple as a personal computer or as complex as an entire networked enterprise management information system. The components of RFID has been shown in Figure 1 (Intermec, 2007).

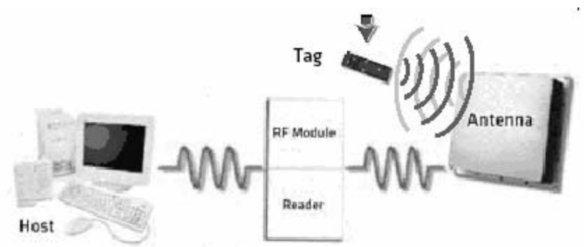



**Figure 1: The components of RFID**

RFID is a generic technology concept that refers to the use of radio waves to identify objects (Auto-ID Center, 2002). It is considered a significant improvement over the traditional barcode, which needs to be read by scanners in "line-of-sight" fashion and can be stripped away if the paper product label ripped or damaged (Shih, Chiu, Chang and Yen, 2008)

The goal is to achieve information sharing and reduction of total cost, thus the operation efficiency can be improved and competitive advantage can be enhanced (Lin, 2009).

## 2. APPLICATION CLASSES OF RFID

The applications of RFID are wide-ranging and include radio tracking of wild and agricultural animals, manufacturing and distribution of physical goods such as automobiles and transmission assembly, shipping and port operations, and pharmaceutical packaging, among others. Also, RFID systems are used for building access control, like "smart cards" for identification at doors and "Easy-Pass" for toll motorways and bridges, like EASYCARD, the first 'touch and go' IC card for mass transport in Taiwan (Shih, Chiu, Chang and Yen, 2008).

RFID technology not only can help businesses satisfy customer requirement, but also increase productivity to stay competitive. Most applications in the manufacturing field focus on using RFID in the finish goods to monitor the product logistic flow (Cheng and Prabhu, 2007)

Manufacturers, retailers, logistics providers and government agencies are making unprecedented use of RFID technology to track, secure and manage items from the time they are raw materials through the entire life of the product (Intermec, 2007).

The RFID system has started to draw attention in various industries recently. The applications may generate solid benefits and advantages on logistics and supply chain management although the cost is high currently. However, the efforts for a complete adoption of RFID technology are usually underestimated, and the real benefits are optimistically overestimated. (Lin, 2009) Potential classes of RFID applications have been shown Table 1. (Shih, Chiu, Chang and Yen, 2008)

RFID systems should not be seen as a substitute for other identification systems like barcodes. Their multifunctional capability can provide additional features that allow the use of this technology for other applications that consequently add value. (Wilding and Delgado, 2004)

**Table 1: Potential classes of RFID applications**

| Application Class | Description |
|---|---|
| Perpetual inventory management | With RFID, every item can be tracked regardless of where it is. RFID also enables companies to know what inventory is coming to them. Finally, it helps retailers keep perpetual inventories at the store level. Thus, real time inventory will be possible throughout the supply chain and these data could enable improved replenishment, reduced order cycle times, in-transit tracking of items, better forecast accuracy, increased flexibility in responding to unexpected demands, improved item locating, and easier recalls |
| Automatic scanning | RFID could reduce the costs involved in these functions by scanning shipments automatically and rapidly, reducing time and effort in the warehouse. All items in a shopping cart could be scanned automatically when a customer leaves the store. |
| Product/asset identification | RFID will help companies identify a variety of assets, from items in a shipment to equipment in a hospital. It can also be used to track component parts in finished goods. |
| Logistics and transportation applications | Logistics providers can use RFID to track specialized containers and trace reusable containers. It will be possible for postal services and package delivery companies to track small parcels in this manner. |
| Customer service applications | Companies that handle products owned by customers could use e-tags to log the receipt of goods, track their progress, and prevent lost items—all electronically. E-tags could also effectively act as proof of purchase and include warranty and service history information. |
| Theft and waste prevention applications | E-tags on products will be able to report when products are stolen, as well as serve as a homing device to report their exact location. Tags could also be used to report when products are reaching their sell-by date, so that they can be quickly sold or returned to the manufacturer. |
| Personal and asset status applications | Some companies are considering adding two-way tags to their ID cards. Then, if an employee feels unsafe or needs help, pressing this button will instantly report his or her location and bring assistance. This feature could also be used in hospitals and other facilities that are open to the public. |

# 3. THE COMPARISON OF RFID AND BAR CODES

Compared to the traditional bar-code technology, RFID possesses multiple advantages such as high storage capacity, remote reading, repeated reading and writing, better data security, and the ability to read numerous tags simultaneously. All industries have to pay attention to this new technology, especially the logistics and retail industries (Lin, 2009).

The main advantages of RFID in comparison with barcode-based solutions are the operability without having sightcontact, the simultaneous capturing of several goods, the storage of additional data on the product, the resistance against water and dust and the fully automated capturing without human intervention. Also, it is possible to uniquely identify individual products, and not only the type and manufacturer of a product. Those properties are the perfect prerequisite to enhance the efficiency and to support computer-based processing within the supply chain (Mueller and Tinnefeld, 2007). Table 2 shows the differences between RFID and barcode systems (Shih, Chiu, Chang and Yen, 2008).

**Table 2: Important Attribute of RFID and Bar coding**

| Characteristics | RFID | Bar Coding |
|---|---|---|
| Reading capability | Wireless-line of sight not necessary (some environmental exceptions). | Optical-line of sight required |
| Reading speed | RFID can read multiple tags in a single pass | Bar coding can read a single label per scan. |
| Durability | RFID tags are capable of storing several thousand characters, or several kilobytes, of information | Labels tend to be damaged in harsh processes. Etching directly onto part has increased durability |
| Amount of information | RFID tags are capable of storing several thousand characters or several kilobytes of information | A 1D bar code can store 20 alphanumeric characters, while a 2D bar code can store roughly 2,000 characters |
| Flexibility of information | To update information, many RFID tags can have their memories updated with new information through wireless communication | To update information, a bar code label must be replaced with a new bar code label |
| Security | RFID tags have manufacturer installed identification codes that cannot be changed, thus making counterfeiting difficult | 2D bar codes provide encryption capability |
| Cost per label or tag | RFID tags cost from \$0.25-\$0.50, up to \$250 | Bar code labels typically cost less than \$0.01 |
| Standards | RFID lacks complete standardization, especially in the global environment | Bar coding is standardized and widely accepted |
| State of infrastructure | RFID is minimal. Users would have to invest in additional equipment to support RFID. | The infrastructure to support bar codes is in wide existence |

# 4. SUPPLY CHAINS AND RFID

Supply chain is a collection of functional activities (transportation, inventory control, etc.), which are repeated many times through the channel through which raw materials are converted into finished products and consumer value is added (Bumbak, 2005).

Supply chain management is defined as the planning and monitoring of materials, information and finances as they move in the process from supplier, to manufacturer, to wholesaler, to retailer and finally to the customer. These flows are coordinated and integrated by the supply chain management. (Mueller and Tinnefeld, 2007)

According to another definition; Supply Chain Management (SCM) is defined as the "management and control of all materials and information in the logistics process from acquisition of raw materials to delivery to the end user" (Michael and McCathie, 2005).

There are two major understandings of SCM. One sees SCM as a logistics-oriented concept which comprises inter-company logistics and the other understanding is SCM as holistic concept which spans across further business functions. In 1997 Cooper, Lambert and Pagh state "there is definitely a need for the integration of business operations that goes beyond logistics […] The integration of business processes across the supply chain is what we call supply chain management". Therefore, SCM aims for improvement of all material, informational and financial flows both within the internal supply chain and the extended supply chain from the original supplier to the end customer (Rochel, 2007).

Supply chain management objective is to increase the long-term performance of individual companies and the overall supply chain by maximizing customer value and minimizing costs. Not all companies achieve these goals with the same strategy. A supply chain is either agile or lean and given this, a different approach to increase the efficiency and effectiveness is adopted. Companies such as Wal-Mart and Dell have gained efficiencies by having a clear understanding and a tight commitment to deliver customer value by maximizing not only the value provided by their companies but also aligning their partner's interest to create unique supply chains. (RFID4U, 2006)

***RFID has been around for years but has only recently been introduced to the consumer goods supply chain. RFID will allow an unprecedented sharing of information throughout our supply chain. Each RFID tag will contain a unique electronic product code (EPC) which is the key to all of the information about the tagged product, including what it is, when it was made, and where it has been. Information related to each EPC will be stored in a central location, sent to partners in the supply chain, or both, so that anyone who needs to access the information can get to it via the Internet (Shutzberg, 2004).***

RFID can provide immediate and tangible benefits throughout the supply chain. Organizations who take the time to understand the technology's capabilities and limitations can increase their inventory visibility while streamlining their operations. (Intermec, 2007)

RFID will have a significant impact on every facet of supply chain management—from the simple tasks, such as moving goods through loading docks, to the complex, such as managing terabytes of data as information about goods on hand is collected in real time. It has a potential to dramatically improve supply chain by reducing costs, inventory levels, lead times, stock outs and shrinkage rates; increasing throughput, quality, manufacturing flexibility, inventory visibility, inventory record accuracy, order accuracy, customer service, and the collaboration among supply chain members. The applications fall in the manufacturing, warehousing/distribution centers, logistics and retailing environments (RFID4U, 2006).

When goods are in the process of distribution, actually in the distribution channels, companies lose control32, as opposed when the goods are in the manufacturing plant or a warehouse where the control is much greater. Being in the channel goods are more 'exposed' and probably easily accessed by criminals so it is the most dangerous part of supply chain, consequently it should have adequate protection. That's why it has special focus along with retail where exposure to felons is similarly high. Inside industrial complexes or a factory, RFID is also in use, but as system is closed, no outside participants, the security risks are low. These closed systems are left out from this research even though they are part of supply chains and are using RFID. The reason for that is that as previously said focus is only on most common and potentially most dangerous problems, which is not the case with closed systems. (Bumbak, 2005)

RFID allows participants in the supply chain to know where a particular product began its life, its current location, and where it has been. The new generation of low-cost RFID tags and readers, combined with emerging software solutions has the potential to deliver unprecedented value for supply chain management, bringing real-time, item-level information, fundamentally changing how inventory is managed across the supply chain. (Nikam and Satpute, 2005)

To participate in the RFID initiative for the consumer goods supply chain, companies cannot just purchase and deploy RFID internally. Instead, this initiative requires that RFID technology be deployed in a standardized and synchronized manner across the entire supply chain, including (Shutzberg, 2004):

- retailers,
- manufacturers,
- third-party logistics (3PLs) providers,
- co-packers,
- packaging and display manufacturers

It also requires:

- the creation and adoption of evolving, industry-wide standards and practices,
- integration with and customization and configuration changes to companies' internal business systems,
- widespread deployment of RFID tagging and reading equipment. (Shutzberg, 2004)

Application of the RFID in the Supply chain is shown in Figure 2. (Moreau, 2003)

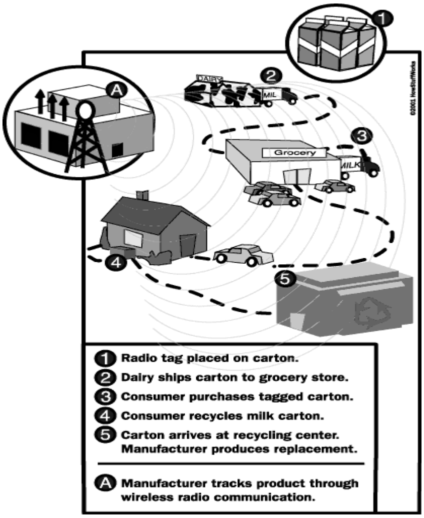



**Figure 2 : RFID Systems in SCM**

The use of RFID systems to track asset provide a distinctive set of benefits. RFID tags enable an increased visibility and accuracy of the asset pool. This visibility and accuracy impacts six main areas: operating costs, shrinkage, lead times, inventory visibility and accuracy, customer service and integration among parents. RFID streamline the management of assets (such as machinery or containers) and increase the efficiency by reducing the equipment needed or reducing labor, thus translating into higher profits. Reduced assets shrinkage, increase ROI. Lead times (total cycle time) are reduced with the increased efficiency to handle the assets (RFID4U, 2006).

The use of RFID achieves benefits in three distinct ways: process automation, closed-loop tracking, and supply chain visibility. As mentioned previously, supply chain visibility is the most commonly mentioned advantage of RFID over bar codes in the literature, and it is expected to produce many benefits in supply chain management. However, these benefits are typically considered long-term benefits of RFID because realisation of visibility requires the mass adoption of RFID, trading partner collaboration, and establishment of technology infrastructure for information sharing. (Tajima, 2007).

Reducing supply chain costs by applying RFID has been suggested as one of the main benefits of this technology. The types of costs that can be reduced include: redirecting products originally intended for one location to another; using alternative transportation modes; changing the product mix in production; reallocating
products to different supply chains; and using pricing and rebates to affect product demand and product substitution. RFID has not just been positioned as a technology to lower the cost of supply chain operations, though, but also to improve the value that is produced for customers (White, Johnson and Wilson, 2008).

One of the most attractive aspects of RFID implementation in supply chains is ROI, because it can significantly reduce shrinkage caused by employee theft and administrative mistake which in U.S. retailers amounts to 1,8% of sales per year. RFID could reduce that shrinkage by 35 %36. As you can see the idea is that RFID will bring great benefits and advantages to the supply chain, but what you can also see, only the positive aspects are presented, so full impact of RFID cannot be judged. Great retailers like Wall-Mart in U.S. and Metro in Europe are already working with RFID in their supply chains and expect to have their entire product range tagged and tracked in next couple of years. This is just one example of how RFID is already here it is no longer technology of the future for supply chain management it is the technology of today (Bumbak, 2005).

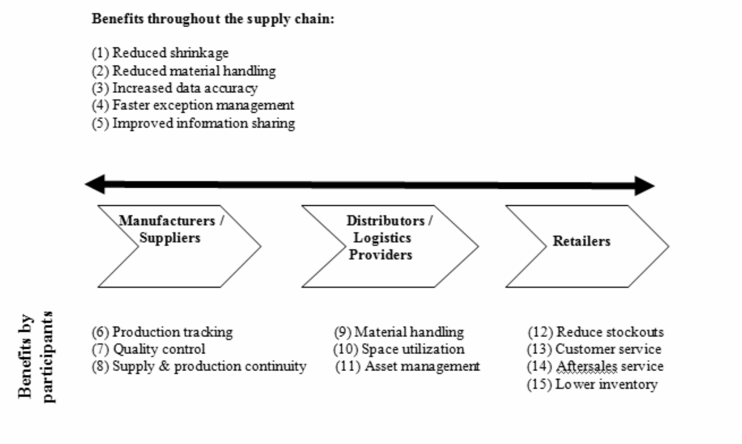



**Figure 3: RFID Benefits Across The Supply Chain (Tajima, 2007)**

Under the concept of SCM (Supply Chain Management), the logistics industry is a key player to integrate the supply chain through information technology. It is expected that the application of RFID in the logistics industry would enhance the operational efficiency of supply chain management. However, there exist several barriers for a corporation to adopt RFID technology effectively and efficiently. For example, there is financial requirement to prepare the facilities for RFID. There is the readability problem since RFID does not guarantee a 100% success rate in the item level. There is the coordination problem because the synergies would be sacrificed if some members in the supply chain do not adopt RFID technology. In such circumstances the small-to-medium size companies would hesitate to apply RFID without outside support. (Lin, 2009)

**Table 3: Barriers of RFID (Shih, Chiu, Chang and Yen, 2008)**

| Barriers | Components |
|---|---|
| **Technical** | • **Lack of standarts** (Standards used to define RFID systems are varied in their levels of acceptance globally. An open standardized system that would heavily accelerate RFID adaptation and the concern of a standardized RFID system is even more important from a global aspect)<br>• **Interoperability** (Without interoperability between different RFID systems, the availability of many functions of RFID tags cannot be fully utilized)<br>• **Read Range** (RFID read-ranges may sometimes be adversely affected by high electromagnetic noise levels in the vicinity of the tag. Large quantities of metal or heavy-duty power supplies in close proximity to a particular tag or reader can reduce the read-range. By carefully selecting the proper equipment and installation site, many of these adverse influences can be effectively mitigated)<br>• **Read Quality** (RFID read rates are approximately 80% currently, it is expected that end users will require read rates approaching 100% before considering a significant implementation of RFID)<br>• **Hardware jamming of RFID** (A portion of the high failure rate can be attributed to environment, such as the presence of metals, liquids)<br>• **Security** (Sensitive data protection)<br>• **To integrate with existing system** (The integrity of the RFID device and the system as a whole is a much larger and complex problem)<br>• **Volume of data** (The data volume generated by RFID could be sizable since RFID tags can carry orders of magnitude with more data than a typical bar code. It is believed that the corporate computer systems in use today are not well suited to handle this level of volume. In addition to volume, the item files in these corporate systems are not currently capable of handling RFID data structures) |

| | |
|---|---|
| **Cultural** | • **Privacy Concerns** (Privacy groups have expressed a concern that RFID, due to its small form factor and RF attributes, will allow monitoring of individuals' behavior without their knowledge. It is believed that proponents of the technology will have to alleviate these concerns through technological innovation and proactive education)<br>• **The relationship between retailers and suppliers** (Neither culture readily shares information about the movement of its products or the activities of its customers. This kind of information exchange, however, is intrinsic to auto-ID and the intelligent e-PC network)<br>• **Environmental Constraints** (RFID is of course subject to the physical laws that affect all RF transmissions. Noise, interference, and distortion must be guarded against, and reader performance must be improved to compensate)<br>• **Lack of education** (It is believed that the majority of potential RFID users lack a clear understanding of the potential RFID benefits, instead they remain weary of RFID's relatively high cost. In addition, many end users view implementation of a new technology as a daunting task. It is believed that penetration will increase as users, vendors, value-added resellers, and system integrators create and deploy RFID applications that offer easy system integration and strong returns on investment) |
| **Financial** | • **Relatively high cost / infrastructure** (RFID's robust functionality can easily lead to significant improvements in supply chain operations; however, it is believed that overall system cost is a keyreason why this enhanced functionality remains under-used. A low-end passive RFID tag costs approximately $0.25-$0.50, with high-end active tags reaching up to $250 each. And RFID requires new infrastructure, where RFID readers can cost $1,200-$3,500 each. Further, RFID solutions often involve a challenging front-end integration process. As a result, many end users have found it difficult to justify the cost of an RFID system despite the apparent incremental benefits ) |
| **Organizati onal** | • **Redesigning Processes** (While RFID can be used in lieu of bar codes, many potential efficiency and accuracy gains will only be obtained by using it in a different manner than bar code-based systems. The main advantage of RFID over bar codes is that it allows object identification in a non-intrusive manner. However, many existing supply chain applications require direct capture of bar codes through user-initiated scans. A truly scan free warehouse will require different processes than one that relies on bar codes. RFID receiving may be an extremely attractive prospect for many distribution operations. But real productivity gains will probably come more from making it a more flow-through process than by merely substituting a RFID read for a bar code scan. Implementing a flow through receiving process may require changes in an operation's shipment check-in, quality, verification, special handling, and vendor performance monitoring procedures)<br>• **Manageability** (The amount of information that will one day reside in and be accessed through an EPC network will be staggering. Successful RFID models will need to be scalable and flexible to store, route, monitor, and manage the expected traffic) |

# 5. SOME CASES OF RFID APPLICATIONS IN SCM

RFID has been widely applied in numerous areas in the supply chain activities such as manufacturing and distribution of physical goods, shipping and port operations and inventory management. Moreover, such an emerging technology has also been further extended to the application domain of warehouse operations in the supply chain. Three cases are summarized below to illustrate the warehousing resource management applications and the resulting benefits using RFID technology (Chow, Choy, Lee and Lau, 2006).

**Case1 : Woolworths, UK – total transparency for item- tote-dolly-container-driver-route-store**
Woolworths involvement with RFID technology came under the Home Office's 'Chipping of Goods' initiative. For this retailer, the losses due to shrinkage, which had an impact on service and inventory levels, were considerable enough to justify a trial with RFID technology. In 1999, a small-scale pilot was launched

and involved one distribution centre and one store. The Woolworths' trial revealed that RFID has potential applications to improve supply chain transparency and to reduce supply chain costs. However, at that time, it was felt that the technology was too expensive, not robust enough and without any universal standards. Moreover there was a lack of a compelling business case to justify further investment in such a new technology. In 2002, and within the Home Office's initiative, Woolworths started another trial using RFID technology in one distribution centre, two stores with fixed RFID infrastructures and 30 stores using mobile RFID infrastructures. In this trial the RFID tags were placed on 16,000 dollies instead of each product item because the average item value of £3 could not support the investment of individual tags. The system uses an integrated approach using various technologies. Products are picked into tote boxes with a unique barcode identification that will be assigned to a dolly identified with a unique RFID tag; this dolly can carry up to ten totes. RFID readers distributed in strategic places within the distribution centre track the dollies' movement in real time and ensure that they are loaded into the correct vehicle ready for despatch. This also allows identification of mistakes before the product goes any further than the dispatch bay. When dispatched, a GPS system tracks vehicles that are associated with the dollies that they carry. Therefore, it is possible to track products through the supply chain from the vehicle level to the item level - item-tote-dolly-container-driver-route-store. At the store, drivers using handheld RFID/barcode scanners confirm the delivery without the need for paperwork related to proof-ofdelivery. Finally, the stores involved in this trial were equipped with fixed position readers that gather and check information on the dollies' contents on arrival from the distribution centre. This original six-month trial was extended and 2,500 deliveries were tracked and the movements of 350,000 tote boxes filled with goods were recorded. The results confirmed improvements on the processes by using information that identifies the causes of supply chain inefficiencies. This situation led to the reduction of costs associated with:

- shrinkage reduction (this was 1.8% of sales)
- reduced labour for deliveries' checking and claims processing
- improved utilisation of totes and dollies
- the reduction of inventory levels, improving product availability and customer service (Wilding and Delgado, 2004)

**Case 2 : Figleaves.com, UK – picking errors down to 0.1%**

Figleaves, a UK-based website that sells intimate apparel, uses RFID technology provided by Texas Instruments to rationalise the picking and shipping of products so avoiding the need to expand their facilities. Items are stored in carts that carry three tote boxes - each of them have up to eight compartments and feature a unique RFID tag. The carts are equipped with radio data terminals that tell the warehouse staff where to go to find the right tote. The system allows the pickers to assemble up to 24 orders on a single cart by selecting the best picking sequences in order to optimise walking distances in a single trip with total accuracy. These picking carts have a built-in radio terminal with a graphics display with picking instructions thus preventing staff from mixing up the orders to be sent out and saving the time and labour spent on double- checking orders before they are shipped. When picking operations are finished, the tote boxes are delivered to a packing bench fitted with RFID readers that identify each tote and associate it with the order. When the order is complete the system prints a delivery note and a label and finally the order is sent to the mail sort. The result is a system that enables staff to pick 60,000 items per month with an error rate of less than 0.1%. This has led the company to expand the use of RFID technology. (Wilding and Delgado, 2004)

**Case 3 : Labor Cost Savings**

Since RFID tags can be read without having a person to scan the object such as in the case of traditional bar-codes, there can be significant labor savings. As line of sight is not required, and since multiple tags can be read simultaneously instead of one at a time, the efficiency savings could be huge. Such labor savings occur in the receiving side of stores or warehouses, as well as in inventory audits. At distribution, some reports estimate that the labor cost reduction can be as high as 30%, while retail stores can see a labor reduction of 17%. AT Kearney estimates the labor savings at manufacturers to be 9% and at retailer stores and warehouses to be 7.5%. Accenture estimates, as reported in 2005 by Lacy, that the savings in receipt is 6.5%, while 100% of the labor in physical inventory count could be eliminated. Accenture also report labor savings in receipt as 5-40%, stocking as 22-30%, cycle counting as 95%, and checkout as 5-45%. McKinsey's estimates are 0.5-1.6% in distribution, and 0.9-3.4% in the stores. SAP's estimates are more aggressive. At retailer warehouses, they estimate a reduction of 20-30% in receiving cost, and 40-50% in picking cost. At stores, they estimate a reduction of 65% in receiving, 25% in stocking, and 25% in cycle counting. Finally, in 2003 Booth-Thomas reports Marks and Spencer obtaining labor saving equivalent to 1% of its revenue in their RFID project (Lee and Ozer, 2005).

**Case 4 : Inventory Reduction**
Most industry reports claim that the higher visibility offered by RFID technology will reduce forecast error and inventory discrepancy (the difference between actual inventory and inventory records), leading to inventory reduction. In 2003 Booth-Thomas cites an Accenture study showing inventory reduction of 10-30% in the supply chain. For inventory at the retailers, AT Kearney estimates a reduction of 5%, while SAP estimates a reduction of 8-12%. Economist cites IBM's estimates to be at 5-25%, while Pisello estimates a more modest rate of 1-2%. Niemeyer et al. put McKinsey's estimate on inventory reduction through VMI (Vendor-Managed Inventory) enabled by RFID, to be at 20-40% (Lee and Ozer, 2005).

# 6. CONCLUSION

In this study, we have examined the RFID technology briefly and its impacts on Supply Chain Management. We have emphasized economic opportunities and challenges about implementing RFID technology within an existing supply chain framework. As described, RFID offers strategic value potential for firms in developing an integrated supply chain to drive earnings and innovation and to gain competitive advantage for strategic management. This advantage is provided by the benefits (progressive quality, manufacturing flexibility, real-time visibility, tracking, inventory record accuracy, order accuracy, the collaboration among supply chain members etc) of RFID. The RFID technology, despite its new appearance on the market is becoming very advantageous and popular. As it is also quite a simple technology and as it is becoming cheaper, it is for sure that firms would use it more frequently. Although RFID has some financial and technical limitations, it is the technological key enabler for a more efficient supply chain management and as it is well known; efficient supply chain management provides cost and competitive advantages for firms. In the near future we consider that most Turkish companies invest in RFID technology to reach long term strategic objectives.

# REFERENCES


Bumbak, M. (2005), RFID and Security, Master Thesis in Logistic Management, Rotterdam Business School, pp.46-48.

Cheng, C.Y. and Prabhu, V. (2007), Applying RFID for Cutting Tool Supply Chain Management, *Proceedings of the 2007 Industrial Engineering Research*, pp.1-4.

Chow, H.K.H., Choy, K.L., Lee, W.B. and Lau, K.C. (2006), Design of a RFID Case-Based Resource Management System For Warehouse Operations, *Expert Systems with Applications*, 30, pp.561–576

Intermec (2007), Supply Chain RFID: How It Works and Why It Pays, White paper, pp.2-4

Lee, H.L. and Ozer, O. (2005), Unlocking the Value of RFID, *Production and Operations Management*, Vol.16, Issue.1.

Lin, L.C. (2009), An Integrated Framework for the Development of Radio Frequency Identification Technology in the Logistics and Supply Chain Management, *Computers & Industrial Engineering*, pp.3-23

Michael, K. and McCathie, L. (2005), The Pros and Cons of RFID in Supply Chain Management, *Proceedings of the International Conference on Mobile Business*, pp.1-7.

Moreau, C.E. (2003), Radio Frequency Identification: The Technology and Supply Chain Application Master Thesis, Lund University, Lund Institute Of Technology, pp.28-50.

Mueller, S. and Tinnefeld, C. (2007), Using RFID to Improve Supply Chain Management, *Publications RFID Paper*, pp.2-11.

Nikam, M. and Satpute, S. (2005), RFID: Changing the face of Supply Chain Management, Welingkar Institute of Management Development and Research, pp.2-9.

RFID4U, EPC Global US, (2006), Benefits of RFID-Enabled Supply Chain.

http://www.rfid4u.com/downloads/Benefits%20of%20RFID-Enabled%20Supply%20Chain.pdf

Rochel, R.C. (2005), RFID Tehcnology Introduction and Impacts on Supply Chain Management Systems, Master of Computing Thesis, School of Computing And Information Technology Mt Albert, Auckland New Zealand, pp. 1-10.

Shih, D.H., Chiu, Y.W., Chang, S.I., and Yen, D. C. (2008), An Empirical Study of factors Affecting RfID's Adoption in Taiwan**,** *Journal of Global Information Management*, 16(2), pp.58-80.

Shutzberg, L. (2004) Radio Frequency Identification (RFID) In The Consumer Goods Supply Chain: Mandated Compliance or Remarkable Innovation?, Rock-Tenn Company, An Industry White Paper, pp.4-28.

Srivastava, B. (2004), Radio frequency ID technology: The next revolution in SCM, *Business Horizons* 47/6, pp.60-68.

Tajima, M. (2007), Strategic value of RFID in supply chain management, Journal of Purchasing & Supply Management, 13, pp.261–273.

White, A., Johnson, M. and Wilson, H. (2008), RFID In The Supply Chain: Lessons From European Early Adopters, *International Journal of Physical Distribution & Logistics Management*, Vol. 38 No. 2, pp. 88-107

Wilding, R. and Delgado, T. (2004), Rfid – Applications within the Supply Chain, *Supply Chain Practice,* Vol. 6, No. 2, pp.31-40.

Wu, N.C, Nystrom, M.A, Lin, T.R. and Yu, H.C. (2006), Challenges to Global RFID Adoption, *Technovation*, 26, pp.1317–1323.

# STRATEGIC APPROACHES TO LOGISTICS MANAGEMENT

**Ruhet Genc**

**Beykent University, Turkey**

**İge Pırnar**

**Dokuz Eylül University, Turkey**

## ABSTRACT

*Logistics management is one of the most vital functions of international business since time, effectiveness and efficiency are the key words in any kind of business. It really is an irreplaceable function in business today since no marketing, manufacturing or project execution can do without logistics support. The paper is a literature review, which consists of applicable strategies to logistics companies and related strategic trends for the future success. Namely, planning, quality management, innovation, consolidation, alliances and partnership, reengineering and benchmarking are the issues that needed to be handled by special attention since changes in the business environment may affect the results expected from them.*

***Keywords:*** *logistics management, strategic applications, strategic logistics management, SWOT analysis, Innovation, Responsive Thinking, Quality Management, Outsourcing.*

## INTRODUCTION

Logistics management is one of the most vital functions of international business since time, effectiveness and efficiency are the key words in any kind of business. It really is an irreplaceable function in business today since no marketing, manufacturing or project execution can do without logistics support. This function is much comprehensive than the traditional definition of "'movement of goods", since it covers functions such as purchasing, plant location, plant layout, disposal of wastes. It also includes facility location, planning, forecasting and order management, transportation mode and route, inventories and protective packaging. As of today in the days of global crisis, the vitality of this function and its strategic applications had gained more importance since strategic applications have direct implications for cost minimization, profit maximization thus success as a whole.

Strategic management in logistics is critical for the company's attainment of its goals and improving customer service. In 1990s, customer service has become an essential concern for logistics companies. The concept of customer service has been redefined through 1980s and the focus of customer service has shifted from physical distribution and transportation of goods to improvement of customer's experience and value-adding applications (Bottani & Rizzi, 2006; Korpela, Touminen & Valoaho, 1998). Within the contemporary trend toward improvement of customer service in the marketplace, logistics functions has become prominent since improvement of customers' experience with the product depends heavily on logistics-related activities such as efficient and timely delivery of goods. The logistics manager occupies a significant position in anticipating a company's potential to respond to a changing environment and satisfy future customer needs since the logistics manager gathers all streams of information regarding the production, distribution and consumption functions of a company and accordingly manages them (Gattorna, 2001).
Due to their significant effect on logistics firms' success results, the study will focus on and review strategic applications related to logistics management like SWOT analysis, quality management, benchmarking applications. In addition, failure points and recommendations for success are gathered from the secondary data.

The paper is a literature review, which consists of applicable strategies to logistics companies and related strategic trends for the future success. Namely, planning, quality management, innovation, consolidation, alliances and partnership, reengineering and benchmarking are the issues that need to be handled by special attention since changes in the business environment may affect the results expected from them.

# STRATEGIC APPLICATIONS IN LOGISTICS

Today as the world is facing global crisis, almost all firms are trying to survive with the help of business strategies. In addition, as the business world is becoming more and more global and competitive, many companies are becoming international to acquire a market share and take advantage of higher production and sourcing efficiencies. Logistics is not different from the whole since the key determinant of business performance depends on the sucess of the logistics function as it makes the flow of materials, products and information throughout the company's supply chains possible. Therefore the firms that want to successfully accomplish their goals and try to stand out form the crowd of competition should put emphasis on strategic applications of their logistics function. The subtopics of strategic applications may be briefly stated as,

- Application of Strategic Planning and SWOT Analysis
- Strategic Alliances and Partnership
- Application of QM , TQM and such quality systems
- Applications of Outsourcing and Benchmarking
- Innovative and Responsive Logistics Thinking

## Strategic Planning and SWOT Analysis in Logistics

Strategic planning has been defined as the course of spotting out the long-term aspirations of a company, developing a road map to attain these aims in the long run, providing direction in a stepwise manner and integrating the company's present and future interests and prospects (Cooper, Innis & Dickson,1992). Taking a more comprehensive perspective, strategic planning shapes a company's present and future since it shapes daily decisions and makes projections about forthcoming trends. Strategic planning can be regarded as a company's game plan which aims a win-win situation.

Strategic planning *in logistics* refers to a holistic process in which all steps in the supply chain are managed in accordance with forecasted demand for logistics activities and company's aims in the long run in order to stand out in the competitive marketplace (Stock & Lambert, 2001). Strategic planning in logistics provides the company with a pre-prepared plan to deal with any changes or crisis situations in a rapidly changing market environment. Through strategic planning in logistics, the company adopts a managerial perspective which shifts its resources from crisis management to future planning, evaluates potential risks and pictures possible scenarios (Stock & Lambert, 2001). Hence, strategic planning in logistics concerns with a long time period and simultaneously involves statement of long-lasting goals, and identification and delineation of the process of achieving them.

The strategic logistics plan is integrative in the sense that it includes marketing and manufacturing applications of a company along with environmental circumstances. For developing a successful logistics plan, political, legal, social, economic and technological environment needs to be considered as macro-level forces which frame the background on which it is formed (Stock & Lambert, 2001). Fred (2009) highlights that for an applicable and beneficial strategic plan, logistics firms should take into account

- *Global Considerations* which impact virtually all strategic decisions
- *E-commerce* which is a vital competitive strategic management tool
- *Natural Environment* which is the most hardly acknowledged, and thus the most important strategic issue

Developing a strategic logistics plan requires information regarding broad activities of the company in various domains. Marketing provides substantial information about products, services and customer profiles along with consumption-related activities such as ordering time and delivery process. Manufacturing information supplies the strategic logistics plan with information regarding production, its site and amount. Financial information makes it possible to forecast costs and evaluate current financial budget of the company to direct its allocation (Lambert, Stock & Ellram, 1993).

A strategic logistics plan is formed on the basis of a firm analysis of the company in terms of its marketing requirements, service and customer characteristics and costs of current and alternative logistics activities. The logistics manager is in charge of evaluating alterative channels and minimizing costs of offering gratifying services and products. Therefore, attaining a summary of production and consumption-related activities of the company and taking into account financial circumstances, the strategic plan provides an all-encompassing route of progression which fits in with organizational values and environmental demands.

The logistics firms which prefer not to do strategic planning indicate the reasons as (Fred, 2009):

- Fear of failure or being unable to achieve the goals
- Overconfidence so that there is no need for a plan
- Prior bad experience, e.g. goals that were not met
- Self-interest
- Fear of the unknown, unexpected results leading to complex situations
- Suspicion about the applicability of the plan

A SWOT analysis may be integrated into a logistics company's strategic plan which is a procedure generally carried out before the development of a business plan. It focuses on the strengths and weaknesses of the organization, and the opportunities and threats coming form outside in the environment within which it operates (Mullins, 2005: 159). Such an analysis may be directed to capitalize on the strengths, eliminate or strengthen the weaknesses (Cerit, Kisi & Tuna, 1995), take advantage of the opportunities and avoid or convert the threats. If applied properly and with the help of contingency plans, SWOT analysis of logistics firms may be developed within suitable strategies.

A SWOT analysis needs to be carried out adopting a holistic perspective and delineates current and future transformations in company's environment along with consequent reactions stimulated by them. SWOT analysis includes an appreciation of the competitive forces in the marketplace and a company's current position in it. Internal resources and transformations in the company's corporate strategies are outlined in the SWOT analysis and thus, it provides an overview of the company's resources and environmental scanning (Gourdin, 2001).

By carrying out a SWOT analysis, firms may be able to figure out the firms' strengths and weakness and to define the opportunities and threats associated with the industry. The applicable strategies may be worked out to be considered for contingency planning. The SWOT analysis is just a brief introduction to main problem areas to be cured and also may be helpful to point out the strong areas for optimizing the opportunities in the logistics environment.

Korpela et al. (1998) emphasizes the strategic significance of customers and proposes a hierarchical analysis of logistics functions in a company with an exclusive focus on customer demand and service-related requirements. In hierarchical analysis of logistics functions in a company, the first step needs to be an evaluation of customer needs, service features, competitors' performance and related logistics requirements which will as a whole guide the process of identifying company goals. Therefore, use of multiple sources and frequent revision and update of company objectives prove to have strategic importance for logistics activities and goal description in the company.

## Quality Management in Logistics

Quality which used to be an issue overlooked by logistics firms is gaining the attention it deserves today. Quality management is a logistics trend that goes hand in hand with marketing activities since no value can be added to logistics function if a product becomes defective, a service delivery cannot meet required conditions or promises are not kept. Logistical costs, once expanded cannot be recovered, if the product is returned delivery and thus, replacement costs add up and accumulate logistics costs.

Quality management is important for logistic functions in contemporary market since quality management practices substantially impact logistics performance of the companies and satisfaction of customers (Anderson, Jerman & Crum, 1998). Quality management is defined as a framework of constant progression which involves implementation of strategies in order to advance service quality, corporate activities and customer satisfaction (Gourdin, 2001). Quality management needs to be prioritized in contemporary strategic management processes, keeping a balance with costs and cycle time and thus, securing service quality and continuation of sales (Lambert, Stock & Ellram, 1993).

Logistics service quality (LSQ) which is a marketing application closely resembling the concept of quality management is utilized by logistics firms in order to increase customer satisfaction. Definition of quality for logistics covers the basics that 1)quality is defined by the customer 2) quality needs management commitment 3) quality management is a constant process which is improved and updated 4) integrated logistics quality may be used to enable strong competitive advantage 5) standards and measurement levels must be developed from the customer's perspective 6) LSQ applications need team work and related training 7) detection of errors is more important than prevention (James & Evans, 1994:42-45).

The definition of service quality stresses that it needs to be described from customers' point of view and improvements in service quality should target areas which are of primary significance to customers. Customer service for logistics is based on: 1) understanding customers needs and wants 2) achieving a service level that has a realistic trade off between revenues and expenses 3) using the latest technology 4) constantly measuring and evaluating performance of individual logistics activities (Lambert and Stock, 1993:146).

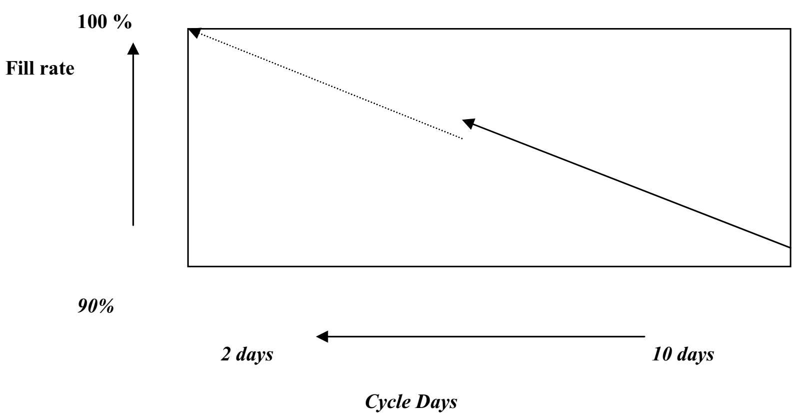
While integrating quality in strategic planning the issues to consider are (Foster, 2007):

- Quality and Price
- Cost
- Productivity
- Profitability
- Environment

In order to improve service quality, an evaluation of the company's current performance in satisfying customer expectations needs to be carried out. A detailed analysis of the problem areas in service delivery along with their sources should be made and costs of offering satisfying and unsatisfying services be evaluated. Therefore, assessment of service quality can be regarded as the success of logistics activities in providing services which satisfy customer needs (Gourdin, 2001).

An important factor in maintaining logistics service quality is in understanding customer expectations. In almost every industry, one or more firms use logistics as a core strategy to gain customer loyalty. These firms allocate their resources to achieve high levels of basic service competency (for example performance at a higher level at a faster rate) that competitors cannot achieve. Increasing customer expectations is illustrated by what is referred as the shrinking service window for logistics which is shown in the Figure 1 by a trend toward performance at a higher level at a faster rate (Bowersox & Closs, 1996:75).

**FIGURE 1: SHRINKING IN SERVICE WINDOW**




**Source (adapted):** Bowersox, J. D., & Closs, D. J. (1996). *Logistical Management*. McGraw-Hill.

For a company to gain competitive advantage, logistics quality management must be well planned, implemented accordingly and controlled. Logistics services should be reliable so that whenever customers demand services, they can get them consistently and predictably. They should also be flexible so that they can adapt to changes and be innovative to enable constant improvement.

In addition to the stated factors, the logistics firms that apply LSQ successfully follow the principles stated below (Bloomberg, Lemay & Hanna, 2002:275):

- They connect their LSQ to their corporate marketing strategy
- Organize LSQ efforts comprehensively
- Get help from information technology
- Put emphasis on team work and human resources
- Form strategic alliances
- Put emphasis on effective financial performance
- Target optimum service levels
- Leverage logistics volumes
- Measure and react to performance

Yet, many firms experience failure in quality applications since they either do not prioritize the adaptation process, or the process lacks top management commitment. Other reasons for failure are not rewarding quality efforts, centralization problems, not using benchmarking when needed (Bloomberg et al., 2002:277).

Total Quality Management (TQM) is an approach that seeks to improve quality and performance which will meet or exceed customer expectations. This can be achieved by integrating all quality-related functions and processes throughout the company. Thus the costs associated may vary from preventive to appraisal and failure costs (Murray, 2009). Since the dimensions of the quality may be stated as below, the logistics firm management should decide on which dimensions are directly affected by operations and logistics activities (Bozarth & Handfield, 2006):

- The Performance
- Features
- Reliability
- Durability
- Conformance
- Aesthetics
- Serviceability
- Perceived Quality

Other key factors of today that will also be topics of tomorrow are competing on cycle time and cost besides competing for quality and customer satisfaction. Cost and cycle time are important issues, since, especially in global logistics costs incurred are higher and timing of delivery due to long distances matter. Logistics firms must carry out the paradoxical task of providing exclusive products at low cost, high-quality, and at short delivery times. The results of the study titled "2002 research on trends and issues on Logistics and Transportation", conducted by Cap Gemini Ernst & Young, Georgia Southern University and the University of Tennessee provides supporting evidence, since out of 365 respondents of logistics professionals 54% replied that their primary focus was on reducing costs while 22% put emphasis on increasing customer satisfaction, 15% on maximizing profitability and 9% on maximizing asset utilization.

## Alliances and Partnerships

Another long-standing trend for logistics has been the customer and business pressure to expand business growth internationally. It seems that globalization will continue to escalate in the business of logistics (Kuglin, 1998:254). The forces driving globalization are many, main ones being economic growth (expanding market share, obtaining access to low-cost and/or high quality labor, material and production capacity), regionalization, deregulation of transportation, logistics firms' perspective and strategy, technology etc. (Bowersox & Closs, 1996:129). Whereas an effective logistics system and application of appropriate marketing strategies is useful for domestic operations, it is essential for global operations. While logistics principles are the same domestically and globally, operating environments are more complex and costly. Cost and complexity are described as 4D's- distance, documents, diversity in culture and demands of customers. Distances are longer. Documentation is more extensive. Cultures and therefore the demands for different customer groups vary widely. The operating challenges faced by global logistics systems vary significantly within operating regions. Therefore developing appropriate marketing strategies to respond to global 4D environment is a hard and complex process for logistics management.

In the past, the placement of manufacturing facilities was decided by the proximity to raw materials and labor sources. Today and especially in the future, it will be determined by the proximity to markets for products and sources of technology which forces small and medium size companies to form alliances and partnerships to access global markets (Kuglin, 1998:255). These alliances and partnerships must work to achieve the level of LSQ that customers require and to adapt to changes in the demand. Moreover, strategic alliances and partnerships may provide an advantageous position in the competitive market structure of contemporary world (Stock & Lambert, 2001).

An alliance is a business relationship which binds two parties into a committed and long term connection and proves to be advantageous for both in a "win-win" situation. Strategic and effective alliances between two parties are established on the basis of shared organizational values, corporate aims, common strategic planning and improved communication among the allied (Alling & Tyndall, 2001). The aim of strategic alliances and partnerships is to improve service quality and customer satisfaction by managing business activities (Gourdin, 2001). Within the competitive market structure, strategic alliances and partnerships also provide an opportunity for the allied firms to decrease their service and logistics costs, and to strengthen their market share (Zinn & Parasuraman, 1997).

Strategic alliances and partnerships vary in terms of their permanence and degree of integration among partners. Some alliances are formed on a long-term basis while others implicate shared strategic arrangements in the short run. Alliances and partnerships encompass either integration of several functions or coordination in multiple areas. Some alliances form a firm relationship between two parties, which view each other as extensions and establish a permanent bond. Strategic logistics activities within these alliances and partnerships differ in their complexity in accordance with the degree of integration among the allied parties.

Zinn and Parasuraman (1997) provide a conceptualization to attain an analytical framework of strategic alliances of two parties in logistics functions and to offer a detailed and comprehensive understanding of the alliance relationship. The authors state that strategic alliances in logistics services vary in their scope and intensity, which refers to the extent of activities within the coverage of alliance and the degree of one-to-one participation among two parties with each other's businesses, respectively. Zinn and Parasuman (1997) highlights that various alliance combinations, differing in their scope and intensity may prove to be beneficial for the allied partners and emphasizes when, where, what and how of strategic alliances formed in logistics sector.

Development of a coordinated international logistics is essential for success in globalization. Integrated logistics systems' benefits range from increased process efficiencies, lower costs, better order fill rates, decreased risks and uncertainties, improved collaboration to increased customer service levels, increased product and process innovation. The requirements of such a system are stated below (Bowersox and Closs, 1996:707):

- The organizational structure must have the capability to transfer the needed knowledge and skills for global operations to national operations

- Global logistics requires a unique set of performance measure standards

- Plans and overall costs of logistics tend to be bigger and higher

- Managerial approach covers a complex set of business relationships.

A logistics firm that wishes to be fully successful all over the world should put emphasis on the points stated below (Frazelle, 2001:21):

- Use of integrated logistics information systems

- Supply chain integration

- Strategic use of third-party and fourth party logistics providers

- Human friendly logistics (ergonomics and green logistics)

- Application of CRM and LSQ

Strategic alliances and partnerships may have a diverse set of implications for the allied partners, which changes in accordance with the nature of the alliance. Strategic alliances which cover a wide range of activities and an in-depth involvement may reduce costs, improve service quality and help to attain a prominent place in the competitive market place, although these alliances are riskier in that they require a high degree of integration between partners, increase dependence among the allied and complicates a possible process of disjunction. Those alliances which include a limited set of activities within alliance coverage may be uncomplicated to put into practice; they may also provide an independent scope of action regarding particular services in the company which are not included in the alliance. However, they may be limited in their impact on cost savings and market share in the competitive environment (Zinn & Parasuman, 1997).

The selection of a strategic partner is vital for firms implementing logistics functions since suitability among the allied partners influences the nature of the relationship formed. Partner selection process requires particular attention from parties of a possible alliance and highlights the significance of both party's acquaintance with each other (Buyukozkan, Feyzioglu & Nebol, 2008).

## Benchmarking and Outsourcing in Logistics

Outsourcing is defined as getting some of the firms' processes done by other people or companies other than the firms'. Another definition implies that outsourcing is assigning a specific business activity to another company with the aim of decreasing costs. Companies offering services on a global scale find it benefcial to outsource particular activities since logistics systmes become more complex and difficult to integrate. With outsourcing, many non-core processes and applications in areas like finance and administration, human resources, marketing, services after sales etc. could be seperated from main logistics areas and thus, leads to the benefits of

- Increased speed and flexibility for the firm

- Reduced cost of operations and increased productivity

- Improved strategic differentiation, enhanced value proposition and competitive positioning

- Enhanced customer satisfaction and increased loyalty

Today and tomorrow, benchmarking practices for logisticians will also remain as a topic to consider, since higher customer expectations will force service providers to be able to respond quickly and improve service levels. Benchmarking which goes hand in hand with marketing, illustrates the ideal way of carrying out a business activity by scanning it in different sectors or companies and sets organizational goals around these performance ideals (Gourdin, 2001). Benchmarking also identifies the gaps between a firm and the best industrial practice ideal, and then assists that firm in closing the gap. Benchmarking is more effective for firms that have been pursuing quality and process improvement over time.

The benchmark is chosen on the grounds that it performs a particular activity most successfully and thus, a benchmark could be in a different sector or within the same company. Benchmarking process involves several steps: 1) assessment of current performance levels and selection of the business function which will be analyzed via benchmarking 2) definition of ideal performance regarding the activity 3) identification of necessary steps in order to improve the activity in the company 4) following a time table.

With the help of benchmarking, the logistics manager may attain superior performance by reaching the following benefits (Quality Publishing) (Bloomberg et al., 2002:278)

- Creating a logistics culture that puts emphasis on continuous improvement
- Increasing sensitivity and flexibility for quick adaptation to changes
- Optimizing the allocation of resources on high-impact opportunities
- Increasing the service quality and effectiveness in cost control
- Focusing resource utilization by using measurable and controllable performance targets
- Giving importance and urgency to the areas that need improvement
- Sharing the best practices between benchmarking partners

In logistics, continuous evaluation of a company's performance is a vital aspect of benchmarking process. Strategic decisions and procedures needs to be implemented when ideal and actual performance levels regarding the benchmarked activity do not correspond. Benchmarking decisions should involve both customer expectations and competitors' applications, with the former enabling the company to gain competitive advantage and the latter helping the company to stand out in the marketplace and thus gather information from internal and external sources (Lambert, Stock & Ellram, 1993; Gourdin, 2001).

The most important question to ask before benchmarking is "whom do we benchmark". Also it is important that there are many types of benchmarking like process benchmarking, financial benchmarking, performance benchmarking, product benchmarking, strategic benchmarking and functional benchmarking, thus it is a vital decision to apply since they are not all mutually exclusive (Foster, 2007).

Problems that may be realized are (Foster, 2007):

- Since this process requires cooperation the logistics firm may experience problems in obtaining cooperation
- Functional benchmarking with firms in non-competing industries makes it difficult to benchmark these firms
- It is not easy to understand your own business process in full before you benchmark someone else
- Benchmarking is time consuming and costly
- It is important to find the best practice in industry which resembles the firm in principles and business doing though it is not an easy selection
- Information obtained through benchmarking needs to be modified to match with the company's characteristics and organizational structure.

# Innovative and Responsive Logistics Thinking: Recognizing the Forces of Change and Adapting Them

Another strategic approach for logistics firm is to respond and follow up with marketplace demands and changes. The ability to create a logistics operation that is innovative and able to respond quickly to customer demand is known as agility. Agility is defined as the ability to move quickly and easily or in managerial terms “a business-wide capability that embraces organizational structures, information processes, logistics systems, and particular mindsets.” (Cox et al., 2003:90). Thus, an agile company can rapidly identify sources of problems emerging from changes in the market place or customers’ preferences and provide inventive solutions (Gourdin, 2001).

In logistics, creating innovation and market-responsiveness are the answers to the agility problem. The first step for responsive logistics operation is to accept the uncertain pattern of innovative products and having flexible plans based on three coordinated strategies mentioned below:

1. Uncertainty minimization: By using all the data on hand and information sources available it is possible to interpret the data so that uncertainty and risk about it may be minimized. The more logistics firm can rely on actual demand rather than forecast, the greater ability it has for agility. For limiting uncertainty, information technology plays a critical role in logistics strategy.

2. Avoiding uncertainty: This is the second strategy applicable to logistics firm which can be achieved by reducing lead times and increasing flexibility, and this will allow logistics firm to produce in order or at least produce at a time when level of demand can be accurately forecasted.

3. Protection (hedging) against uncertainty: Logistics firm may hold the inventory which will act as a buffer against the remaining uncertainty (that is left from having reduced and avoiding uncertainty). Another way the responsive logistics firm can hedge against unpredictability is by holding and reserving excess capacity. How this capacity is utilized will be according to the demand information to be received at a later date.

There is another strategic dimension associated with innovation when deciding on purchasing. For a logistics firm to be successful, it should be innovative in terms of functionality, namely quality and service level of the products and services they provide. In this regard, the key to business success is the ability to understand the utility functions (LSQ and service level) and the added value it brings to the customers and the market. This implies that when market differentiation is the chosen strategy for the logistics firm, it should put emphasis on constant R&D activities about functionality innovations on customer expectations rather than concentrating on reduction of costs through process efficiency.

In addition, though it is quite a new topic in logistics, the studies on anticipating and responding to changes in customer’s desired value, understanding and responding to these changes and detecting the coming changes are becoming areas of research in logistics literature (Flint, 2000).

One major environmental change which faces logistics services of the current information age is prevalent use of internet and other communication technologies. The use of internet has brought to the fore the concept of e-logistics and e-logistics based strategic alliances, and paved the way for new channels and forms of cooperation among different firms In creating agile supply chains and logistics activities, e-logistics has become a cornerstone in the current age of information and technology (Ericsson, 2003). E-logistics can be defined as the strategic use and integration of information and communication technologies provided by current technical improvements and, extension of transaction opportunities in the logistics sector (Bolseth & Solem, 2003).

The internet and information technologies have a dramatic impact on logistics services since they provide firms with multiple channels to transact and establish strategic alliances and thus, necessitate innovation and implementation of new strategic management approaches and tools. Developments in information and communication systems of contemporary world offer novel ways of communication and cooperation among firms and alter the nature of relationships between firms. Via internet, formation of strategic alliances is facilitated and information flow among allied companies is quickened (Bolseth & Solem, 2003).

Bolseth and Solem (2003) state that the use of internet highlights the significance of logistics services in helping a firm or product standing up in the competitive marketplace and call attention to the interdependence of logistics services-information technologies to attain profitable results. Advances in communication technologies also provides companies with an efficient way of managing their wide-ranging services and helps companies to establish better integrated logistics systems. Firms which acknowledge the strategic significance of logistics services in the competitive market environment, use of improved communication technologies may expand a comprehensive and integrated logistics function (Stock & Lambert, 2001).

# CONCLUSION

Contemporary marketplace is in a process of constant change and transformation, increasing in its competitiveness, complexity and scope. Current competitive market structure prioritizes customer satisfaction and forces companies to adopt strategies for improving customer service. In advancing customer service and attaining company objectives, logistics functions have become a vital aspect of offered services and strategic approaches to management of logistics have gained prominence. Strategic approaches to current logistics management trends, such as strategic logistics planning, quality management, alliances and partnerships, benchmarking and outsourcing, and innovative logistics thinking, are outlined in the present study.

Companies can be unwilling to apply strategic logistics plan due to their previous experiences on unmet of goals, or suspicion of the applicability of the plan. Targeting these worries, companies can adopt a logistics strategic plan basing on the results of SWOT analysis (Gourdin, 2001). Moreover, they can utilize hierarchical analysis of logistics functions for determining companies' strategic goals and functions within logistics domain (Korpela et al., 1998). Service quality, corporate activities and customer satisfaction can be enhanced through quality management in logistics (Gourdin, 2001). Total quality management (TQM) and specifically logistics service quality (LSQ) are prominent strategic applications in logistics for quality management.

Besides, many firms utilize strategic alliances and partnerships for enhancing service quality, customer satisfaction and particularly management international business activities. Companies that have alliances and partnerships in global market are suggested to utilize integrated logistics information system and supply chain, strategic use of third party and forth part logistics providers, green logistics, ergonomic and strategic applications of CRM and LSQ. Benchmarking and outsourcing are other strategic applications of logistics management. Other strategic application area in logistics management is agility. In order a logistic firm to respond quickly to highly changing demand in the marketplace, it should utilize strategies to enhance agility. The minimization, avoidance and protection from uncertainty are main strategic ways to improve agility in logistics transactions. Innovation is other area of strategic application. Information technologies and particularly use of internet can be utilized particularly for enhancing integrated logistics functions (Stock & Lambert, 2001).

.

Strategic management of logistics services in today's world provides companies with an effective way of adapting to changes in the market environment, meeting customer demand in a timely and cost-effective manner and offering profitable business arrangements. Thus, logistics services and strategic approaches to management of logistics are becoming the cornerstone of today' business world.

# REFERENCES


- Alling, P. C., & Tyndall, G. R. (2001). Corporate profitability and logistics. In J. L. Gattorna (Ed.), Handbook of Logistics and Distribution Management, Gower Publications.

- Anderson, R. D., Jerman, R. E., & Crum, M. R. (1998). Quality management influences on logistics performance. Logistics and Transportation Review, 34, 137-148.

- Benchmarking. (n.d.). Retrieved May 4, 2009, from http://www.qualityamerica.com/knowledgecente/articles/cqm5_A6.html

- Bloomberg, J. D., Lemay, S., & Hanna, J. B. (2002). Logistics (International Ed.). New Jersey: Prentice-Hall.

- Bolseth, S., & Solem, O. (2003). Strategic implications of e-logistics. Proceedings of Logistics and Digital Economy, Austria.

- Bottani, E., & Rizzi, A. (2008). Strategic management of logistics service: A fuzzy QFD approach. International Journal of Production Economics, 103, 585-599.

- Bowersox, J. D., & Closs, D. J. (1996). Logistical Management. McGraw-Hill Professional.

- Bowersox, J. D., Closs, D. J., & Cooper, M. B. (2002). Supply Chain Logistics Management (International Ed.). McGraw-Hill Professional.

- Bozarth, C. (2006). Introduction to Operations and Supply Chain Management with Advanced Decision Support Tools. Prentice Hall.

- Buyukozkan, G., Feyzioglu, O., & Nebol, E. (2008). Selection of the strategic alliance partner in logistics value chain. International Journal of Production Economics, 113, 148-158.

- Cerit, A. G., Kisi, H., & Tuna, O. (1995, October). Strategic marketing planning for the yachting companies, marinas and yacht builders: An application for Turkey in yachting technology. Paper presented at the 1st International Yachting Technology Conference, Cesme, Turkey.

- Cooper, M. C., Innis, D. E., & Dickson, P. R. (1992). Strategic Planning for Logistics. Council of Logistics Management.

- Cox, A., Ireland, P., Lonsdale, C., Sanderson, J., & Watson, G. (2003). Supply Chain Management. Prentice-Hall.

- Cravens, D. W., & Piercy, N. (2003). Strategic Marketing ($7^{th}$ Ed.). Irwin: McGraw-Hill.

- Eren, E. (2003). Strategic Management (Stratejik Yönetim). Eskişehir: Anadolu University Press.

- Flint, D. J., & Mentzer, J. T. (2000). Logitisticians as marketers: Their role when customers' desired value changes. Journal of Business Logistics, 21, 19-46.

- Foster, T. S. (2007). Managing Quality: Integrating the Supply Chain ($3^{rd}$ Ed.). Prentice-Hall.

- Frazelle, H. E. (2002). Supply Chain Strategy. McGraw-Hill.

- Burgess, R. (1998). Avoiding supply chain management failure: Lessons from business process re-engineering. The International Journal of Logistics Management, 9, 15 – 23.

- Fred, D. (2009). Strategic Management: Concepts & Cases (12th Ed.). Prentice-Hall.

- Gattorna, J. (2001). Managing logistics in a changing environment. In J. L. Gattorna (Ed.), Handbook of Logistics and Distribution Management, Gower Publications.

- Gourdin, K. N. (2001). Global Logistics Management, Oxford: Blackwell.

- James, W. D., & Evans, J. R. (1994). Total Quality: Management, Organization and Strategy. MN: West Publishing Company.

- Korpela, J., Tuominen, M., & Valoaho, M. (1998). An analytic hierarchy process-based approach to the strategic management of logistics service: An empirical study in the mechanical forest industry. International Journal of Production Economics, 56-57, 303-318.

- Kuglin, F. A. (1998). Customer-Centered Supply Chain Management: A Link-by-Link Guide. NY: Amacom.

- Lambert, D. M., Stock, J. R., & Ellram, L. M. (1993). Fundamentals of Logistics Management. Singapore: McGraw Hill.

- Mullins, J. L. (2005). Management and Organizational Behavior (7th Ed.). Prentice-Hall.

- Murray, M. (n.d.). Quality in the supply chain, Retrieved May 4, 2009, from http://logistics.about.com/od/qualityinthesupplychain/a/TQM.htm

- Stock, J. R., & Lambert, D. M. (2001). Strategic Logistics Management. Singapore: McGraw Hill.

- Ericsson, D. (2003). Supply/demand chain management: The next frontier for competitiveness. In D. Walters (Ed.), Global Logistics and Distribution Planning. Kogan Page Publications.

- Year 2002 Report on Trends and Issues in Logistics and Transportation. Retrieved May 4, 2009, from http://coba.georgiasouthern.edu/centers/lit/report2002.pdf.

- Zinn, W., & Parasuraman, A. (1997). Scope and intensity of logistics-based strategic alliances: A conceptual classification and managerial implications. Industrial Marketing Management, 26, 137-147.

# LEAN PHILOSOPHY IN STRATEGIC SUPPLY CHAIN MANAGEMENT AND VALUE CREATING

**Bülent Sezen**
**Sema Erdoğan**

**Gebze Institute of Technology, Turkey**

*"The battlefront in today's competitive wars, and the ultimate core competency of a business organization, is the design of the supply chain." – Charles H. Fine, Clockspeed*

## ABSTRACT

*After the Second World War, while oil crises rise all over the world, managers tried to find out the secret of Japanese strategic management decisions. For the Japanese, who originated a new organizational form, which employed the lean production methods, as known as Toyota Production System; the customer satisfaction and high quality are the competitive advantages.*

*Besides for the western managers, lean production was a scary thing, "when an industry is dominated by mass producers" (Cooper, 1995).*

*From the history up today, this paper aims to introduce the lean philosophy in the strategic supply chain management and its processes. Nowadays the lean tools are used to reduce wasteful activities across the supply chain.*

***Keywords:*** *Lean Production, Lean Philosophy, Strategic Supply Chain Management, Value Creating.*

## INTRODUCTION

The main purpose of the lean production is to eliminate the waste in every step of work processes in the enterprises. It comes from the Toyota Production System, which was examined by the Massachusetts Institute of Technology (MIT) in USA and introduced in the name of "lean production system" in the literature by Womack et al. (1990).

Actually in the development of the term "lean" was firstly used by Krafcik (1988) to describe the system of Japanese, who worked at International Motor Vehicle Program Research Affiliate Team in MIT, too. According to them the system was "lean", because it can do more with less.

Lean is a systematic approach to enhancing value to the customer by identifying and eliminating waste (of time, effort and materials) through continuous improvement, by flowing the product at the pull of the customer, in pursuit of perfection (Manrodt, 2008). In this study the authors aim to focus on the importance and history of the lean production in the strategic supply chain management and their implementations, so in the next sections first the history, and then the principles and strategies of the lean applications in supply chain will be introduced.

## The History of Lean Production

Today lean production is a well-known philosophy, which fights for eliminating waste in the firms. After the Second World War, when Toyota was aware of this opportunity to reach efficiency at its production system, the mass production was more popular all over the world.

Taiichi Ohno, one of the founders of "the Toyota Way"; pointed out in his distinguished book about Toyota, until the oil crisis (in 1970s) there was little interest on what Toyota was doing (Ohno, 1996). Thus, it seems that Toyota was well aware of its productivity advantage at the time (Holweg, 2007). Although lean production was developed through the study of the Japanese automotive industry, Womack and Jones argue that its approaches and the way of thinking can transcend cultural and industrial divides (McIvor, 2001). They also mentioned in their later-dated book (Womack and Jones, 2005) that lean production can be applied in every company, industry and country if it is taken seriously.

It took several years before wider academic and practitioner circles would pick up on the topic (Holweg, 2007), by the time the buyers and suppliers have to work harder to reduce the costs of products or services in the competitive area. And recently, the lean principles were defined and adopted by many different industries.

For the implementers, lean production principles are the way that enables to reduce the costs and with a little effort improves the efficiency and quality, which is the core meaning of the lean. For full effectiveness, the lean production system must be extended down through the supply chain (McIvor, 2001). All the key players of the supply chain must be in this play to reduce costs and to improve the quality and profits.

From academicians or practitioners' point of view lean production has become a philosophy in the strategic supply chain management. The Association for Operations Management (APICS) defines lean as a philosophy of production that emphasizes the minimization of the amount of all resources used in the various activities of the enterprise (Abbott et al., 2006).

## Lean Principles and Creating Value Stream

Lean production is an integrated socio-technical system whose main objective is to eliminate waste by concurrently reducing or minimizing supplier, customer and internal variability (Shah and Ward, 2007). That's why the principles were identified like a recipe of effectiveness by Womack and Jones in the 90s first for the automobile and than for all industries. Lean principles were examined against the non-value adding activities. The book "*Lean Thinking*" introduced the five important principles of lean production in 1996. The five main organizing principles for creating a lean production system are (1) specify value by product, (2) identify the value stream for each product, (3) make value flow without interruptions, (4) let the customer pull value from the producer, and (5) pursue perfection (Hallam, 2001).

The benefits of this lean transformation are measured by metrics such as improved productivity (increases of 2 to 4 times), reduced inventories and work in progress (by as much as 99%), and lead times for products that drop from weeks or months to minutes or days. All of these metrics point to an operating/management system that is considered beneficial to a company, and especially to its bottom line profitability. (Hallam, 2001)

The logic behind lean thinking is that companies jointly identify the value stream for each product from concept to consumption and optimize this value stream regardless of traditional functional or corporate boundaries (McIvor, 2001). The lean enterprises collaborate with customers and suppliers and their relationships along the value stream are crucial to achieving "leanness" (McIvor, 2001).

## Lean Supply Chain

A lean supply chain is defined (Abbott et al., 2006) as a set of organizations directly linked by upstream and downstream flows of products, services, finances and information that collaboratively work to reduce cost and waste by efficiently and effectively pulling what is needed to meet the needs of the individual customer. This strategic decision to implement the lean production system is a managerial approach, but it affects from the top to the bottom in every stage of works, because the lean principles enable the employers to have the authority. In application for example, the employers ask five "why"s to solve the problem when a machine breaks down.

A lean supply chain includes a value stream through the customers and the suppliers have to play a strategic role to achieve a lean production system. As an example, when the lean system set between Tesco and its cola supplier; in 1996 the level of service was 98.5 % compared with the level of service 99.5 % in 2005 after the lean solution. There was also five storage locations between bottler and customer in 1996, and after lean supply chain solution there were two storage locations in 2005 (Womack, 2005). The result of Tesco case was the highest availability, lowest stock levels and the smoothest order signals (Jones, 2005).

The notion here is that buyers and suppliers are locked together in long-term, obligatory relations as distinct from the historical Western model of short-term competitive relations where contracts are awarded largely on the basis of price (McIvor, 2001). In opposite to the out-of-fashion Western management style, the price competition will be reflected to the cost reduction through the lean supply chain management in the long-term.

The characteristic of the lean supply is getting the customers exactly what they want, providing value where they want and fulfilling the orders when they want with high quality and with lowest cost. Nevertheless, it is an interesting point in application of the lean processes that the success of the customer and supplier embracing collaborative relations is heavily dependent upon the attitudes of the people from both organizations who manage the relationship at the operational level (McIvor, 2001), therefore the lean supply chain integration must be transmitted properly in every level of employers.

## Lean Supply Chain Management as a Strategy

Lamming argues that lean supply cannot be achieved unless some kind of close relationship, built upon mutual trust and openness is present, which is not compatible with an arm's length strategy (Lamming, 1993 in McIvor, 2001). According to this strategy, the customers turn into partners and adopt a view of "being in the same boat". As Toyota realized, optimizing a part of the process is different from optimizing "the whole", that's why the customers' and suppliers' opinions had to be included in every change decision (Abbott et al., 2006).

As a firm strategy the terms lean production and supply chain management must be clearly understood. Comparing lean and supply chain management is given in Table 1 to introduce the focus of each system.

**Table.1** - Comparing Lean and Supply Chain Management (Manrodt, 2008)

| Lean Production | Supply Chain Management |
|---|---|
| Focus on reduce waste and non-value-add activities | Goal is reduced lead-times/cost through various methods |
| Traditional focus and success primarily with optimizing shop floor | Focus to optimize across supply chain partners |
| Uses a set of structured tools | Applies Lean tools as well as leverages other tools (Sig Sigma, TQM, etc.) |
| Emphasis on no inventory through "continuous flow" | Emphasis on minimizing inventory through various techniques |

So, the two systems engaged around two major goals: 1) reducing the costs and non-value-add activities, 2) optimizing time. Lean supply chain dimensions can change firm by firm, but the core aim of this lean strategy does not change. Leanness must sound for customer or supplier the same meaning, that is, fighting against waste and non-value adding activities through cost reduction.

# CONCLUSION

After the Japanese experiences in automobile industry, the lean production system (as known as Toyota Production System) was examined by Western academicians in MIT in International Motor Vehicle Program. When the term "lean" was popular in this area, the academicians and practitioners realized that it could be implemented to the other sectors, too.

As a management strategy, the lean production system fits to supply chain management, which focuses to optimize the efficiency in the work progresses. Lean production is an application in or intra-firms that enable the managers and also employers to manage reducing waste and cost. It can be implemented through some tools like Kanban, JIT, TPM, 5S, etc. The tools can also fit to the whole supply chain, which is integrated to each key player (customers and suppliers).

Today the lean tools are used to reduce wasteful activities across the supply chain. It is an opportunity, when the companies need to develop new strategies in today's competitive area, that the lean production system can bring new solutions. The solutions address the business needs, not just consumers' product needs; it can be 1) the right products, 2) the right processes, or 3) the right information (Jones, 2007). Jones (2007; 35-36) argues that also the new mindset of the "lean" managerial approach does not create only huge opportunities to eliminate waste and therefore cost, but it creates also revenue-generating innovation.

In conclusion, the lean approach brings the enterprises a value stream, which is called a business model thing. The lean transformation in the firms or in supply chain management is not "just" a supply chain thing, to be delegated to a specialist and forgotten about. From today's perspective this is both a mindset and an operational step change (Jones, 2007).

# REFERENCES


Abbott, Jeff, Manrodt, Karl B. and Vitasek, Kate (2006), Understanding the Lean Supply Chain: Beginning the Journey, *2005 Report on Lean Practices in the Supply Chain*.

Cooper, Robin (1995), *When Lean Enterprises Collide*, Harvard Business School Press, Massachusetts, USA.

Hallam, Cory R.A. (2001), Lean Thinking – Banish Waste and Create Wealth in Your Organization, Book Review, http://web.mit.edu/esd.83/www/notebook/Lean%20Thinking.doc

Holweg, Matthias (2007), The genealogy of lean production, *Journal of Operations Management*, 25, pp.420-437.

Jones, Daniel T. (2005), "Get me exactly what I want", *Frontiers of Lean Summit*.

Jones, Daniel T. (2007), The Invisible Opportunity, *International Commerce Review*, 7(1), pp. 32-44.

Krafcik, John F. (1988), Triumph of the Lean Production System, *Sloan Management Review*, Fall 1988, pp.41-52.

Manrodt, Karl B., Vitasek, Kate and Thompson, Richard H. (2008), Lean Practices in the Supply Chain, Jones Lang Laselle 2008 Report, http://podcastfiles.am.joneslanglasalle.com/u/docs/285.pdf

McIvor, Ronan (2001), Lean supply: the design and cost reduction dimensions, *European Journal of Purchasing & Supply Management*, 7, pp.227-242.

Ohno, Taiichi (1996), *Toyota Ruhu* (Çev: Canan Feyyat), Scala Yay., İstanbul.

Shah, Rachna and Ward, Peter W. (2007), Defining and developing measures of lean production, *Journal of Operations Management*, 25, pp.785-805.

Womack, James P. (2005), How Lean Consumption Transforms Manufacturing & Supply Chain, *Industry Week Smart Manufacturing Conference*, Illinois.

Womack, James P. and Jones, Daniel T. (2005), *Lean Solutions - How Companies and Customers Can Create Value and Wealth Together*, Free Press, New York, USA.

Womack, James P., Jones, Daniel T. and Roos, D. (1996), *Lean Thinking*, Simon and Schuster, New York.

Womack, James P., Jones, Daniel T. and Roos, D. (1990), *The Machine That Changed The World*, Rawson Associates, New York.

# THE RELATIONSHIP BETWEEN FIRM INTELLECTUAL CAPITAL AND THE COMPETITIVE ADVANTAGE

**İpek Koçoğlu**
**Salih Zeki İmamoğlu**
**Hüseyin İnce**

**Gebze Institute of Technology, Turkey**

## ABSTRACT

*Previous studies rarely examined the relationship between intellectual capital and competitive advantage. Most studies underestimate the shift towards knowledge based economy where, capital and work are no longer the differentiating and generating factors of sustainable competitive advantage. Relatively, little is known in the literature about how intellectual capital affects competitive advantage. This study will contribute to the literature by proposing a theoretical model considering the relationship of intellectual capital with the creation of competitive advantage in knowledge intensive organizations. Additionally, the extensive literature review will be utilized in the development of five hypotheses linking intellectual capital with competitive advantage. The hypotheses show that, human capital, organizational capital and relational capital positively influence competitive advantage. Moreover the positive influence of intellectual capital on strategy formulation and the positive influence of strategy formulation on competitive advantage constitute the basis for the hypothesis; intellectual capital positively influences competitive advantage. The last hypothesis is based on the positive influence of innovation on competitive advantage regarding the positive relationship between the relational capital and innovation. A future research opportunity can be the statistical testing of the hypotheses with the survey method.*

***Keywords**: Intellectual capital, competitive advantage, human capital, organizational capital, relational capital, knowledge based economy.*

## INTRODUCTION

In today's competitive global market, value creating factors for companies are changing. Silvi and Cuganesan (2006) refer to Eustace's statement saying, "a fundamental shift in the corporate value system, away from physical and financial assets towards the creative exploitation of a nexus of intangible assets, quasi-assets and competences – mainly in the form of distinctive capabilities deriving from knowledge intangibles" (Silvi and Cuganesan, 2006). Competition is forcing many companies to accumulate intellectual assets and to seek to use them effectively to produce profitable actions (Bismuth and Tojo, 2008). "Information society", "knowledge society", and "knowledge economy" are some of the concepts that were coined in the twentieth century to highlight the role of knowledge as the critical and differentiating key of economic growth (Lavanderos, 2008). On the opposite of other primary resources, knowledge does not diminish as it is used, instead it gets depth as it is used and shared. Consequently knowledge intensive firms rely on the management of the knowledge which will be adding value to the knowledge workers, products and interactions (Seetharaman, Saravanan and Teng Low, 2004). When in the transition from 1930's to 1960's the enterprise objective shifted from being profit maximization to value maximization, it has been recognized that the economic and productive capacity of an organization lies more in its intellectual and service capabilities than its hard assets. Regarding this new environment, characterized by increasingly global markets, dynamic, uncertain environment and competitive conditions, companies need to be able to earn economic returns from intellectual assets, accordingly intellectual capital is becoming a crucial factor for a firm's long-term profit and performance in the knowledge-based economy as more and more firms identify their core competence as invisible assets rather than visible assets (Bismuth and Tojo, 2008; Hsu and Fang, 2008). Capital and work are no longer the differentiating and generating factors of sustainable competitive advantage. As a result intangibles have drawn the attention of companies (Lavanderos, 2008). It is increasingly recognized that the performance of any organization, is substantially dependent upon the knowledge of its employees, the application and integration of that knowledge to the structures of the organization, and its relationships (Silvi and Cuganesan, 2006). Nonaka and Takeuchi focuses on the reality that the future will be constructed on a knowledge-based society in which knowledge storage and application are the basis of economic growth and accumulated capital, additionally in the knowledge-based economy, learning and knowledge are the key parameters of the sustainable competitive advantage function.(Hsu and Fang, 2008; Smith and Hansen, 2002). The organizations cannot create unique values to customers unless it has unique capabilities based on the differentiation rather than operational effectiveness because industries in such a society do not rely on traditional production factors for their competitive advantage, but on knowledge management and integration (Smith and Hansen, 2002; Hsu and Fang, 2008). This trend stresses the importance of intellectual capital as a promoting factor on competitive advantage. Despite the fact that intellectual capital and competitive advantage are so important for the development of firms, few studies focus on how these two factors relate to and trigger each other. Guthrie and Petty (2000) note that works on the framework placing intellectual capital as instrumental in the determination of enterprise value are lacking in the literature. The factor that generates enterprise value is regarded as the competitive advantage of a firm (Guthrie and Petty,2000). Contingently, intellectual capital as the instrumental determinant of enterprise value, using the mediating role of the competitive advantage, constitutes a gap in the literature. Guthrie and Petty (2000) mention the argument of Roos et al. (1997) presenting that intellectual capital can be linked to other disciplines such as corporate strategy. From a strategic perspective, intellectual capital is used to create and use knowledge to enhance firm value (Guthrie and Petty, 2000). The fundamental question is; is it the intellectual capital of the firm that leads to succeed long term, sustainable, unbeatable competitive advantage, in today's global market?

This study will contribute to the literature by proposing a theoretical model considering the relationship of intellectual capital with the creation of competitive advantage in knowledge intensive organizations. The exploratory research question to start with is; "Does intellectual capital provides the achievement of sustainable competitive advantage in today's globally competitive market of knowledge-based economy?" The main purpose of this study is to explore the intellectual capital, rather than the traditional tangible assets –land, facility, work force, physical and financial capital- considered as capital, in depth as a crucial factor creating the competitive advantage for the organizations in turbulent markets, shifting towards dynamic nature and mainly from production based to the knowledge based economy. In addition to examining the relationship between firm intellectual capital and competitive advantage, this study develops a platform through which intellectual capital will shape the vision, mission and strategic management of the organizations. Previous studies rarely examined the connection and relevancy of intellectual capital, and the competitive advantage as an indicator of successful strategic management. Noticing the transformation of firms' main goals from the profit maximization to value maximization, the intellectual capital that assures the creation and management of knowledge became the most important asset of the knowledge based economy, since the knowledge is the creator of value and effective management of knowledge is the factor maximizing value.

## Intellectual Capital

The fact of calling intellectual "capital" makes reference to its economic roots, because it was first described in 1969 by the economist Galbraith as a process of value creation and as a bundle of assets at the same time. The economist Kenneth Galbraith presented intellectual capital as the difference between market value and book value. Consequently, the roots of the intellectual capital in businesses appeared as an application for the aim of understanding what constitutes the value in the business environment to effectively, hence strategically manage the value creating assets in the business environment (Sveiby, 1997; Edvinsson and Malone, 1997; Johansson, 1999). The historical perspective is an essential component in fostering an understanding of the context within which IC came to be viewed as the essential business element that it is today (Guthrie and Petty, 2000). Plenty of arguments have been discussed in the literature regarding the reasons to understand intellectual capital, ranging from the theme that IC matters in Stewart's (1997) work, to recognizing intellectual capital has the potential to improve the efficiency of both capital and labor markets (Guthrie and Petty, 2000).

Intellectual capital, started to be popularized in the business life with Tom Stewart's article titled "Brainpower" which was published in Fortune magazine in 1990's. Stewart, in his article defined intellectual capital as the cumulative collection of al the assets that create value for the organization which provides competitive advantage in the market for the firm (Sullivan, 2000). The term intellectual capital is used as a synonym for intangible or knowledge assets since the work by Stewart (1991).

The works on intelectual capital reflects two separate but consequent periods where intellectual capital evolved from what it was to what it is now. The studies untill the mid 1990's constitute the first period and the studies after this period represent the second period of the intellectual capital research. The first period efforts was focused on the aim of generating the consciousness about intellectual capital and raising the awareness for intellectual capital in creating and managing a sustainable competitive advantage. The publications in this period was gathered under the common subject of "there is a conceptas intellectual capital, it has a critical role and there is need to measure and report it." In the second period, researchers strated to go down to more micro level, meaning that they started to consider intellectual capital from the organization's perspective. This stage has been one of consolidation that established research into IC as a legitimate undertaking and has sought to gather robust evidence in support of its further development. The focus is on the perception of intellectual capital's importance regarding the behavior of labour and capital markets (Guthrie and Petty, 2000). Yet, a further stage appears in today's literature, since now entrepreneurs and business men know the urgency, neccessity and importance of intellectual capital, also know that they hide some value to be brought out in their organization under the shelter of intellectual capital but they don't know how to obtain value out of this capital. The next stage of efforts which this study aslo focuses on is the influence of intellectual capital to company performance, including competitive advantage. Tan et al. claims that regarding this stage there is a gap in the literature (Tan et al., 2008).

Consequent to the emergence and acceptance of intellectual capital, the question regarding the urgency of it today arises. Why the implication of intellectual capital, started in recent economic, managerial, technological, and sociological developments whereas it was previously unknown and vastly unforeseen? The reason why intellectual capital becomes crucial for the enterprises, lies behind the changes in the business conditions giving birth to the knowledge-based economy. The revolution in the information technology and information society, the rising importance of knowledge and knowledge-based economy, the changing patterns of interpersonal activities and the network society, the emergence of innovation as the principal determinant of competitiveness, are the factors emphasizing intellectual capital instrumental in the determination of enterprise value (Guthrie and Petty, 2000: 157).

Today, intellectual capital is the subject of increasing research by both academics and practitioners (Petty and Guthrie, 2000). It is also an area of increasing government interest and funding (Tan, Plowman and Hancock, 2008). There are as many definitions as existing researchers dedicated to the development of this subject. Though a universally accepted definition on the intellectual capital is still absent. Kaufmann and Schneider (2004) mentions the claim of Bukh et al. (2001) in his study who states that no unique definition for intellectual capital exists and claims that, "it is a fragile construct, which has to be continuously supported and held together by a whole array of interrelated elements"(Kaufmann and Schneider, 2004). Even if there are other sources of definitions excluded in the study of Kaufmann and Schneider (2004), the authors have identified thirty seven definitions about the intellectual capital. According to Lavanderos (2008); if the other sources which were not included in their study, such as Brooking, Andriessen, Bueno, Viedma, the Meritum Project, the Intellect Club, Allee and Saint Onge are added, there wil be reached over forty five other definitions (Lavanderos, 2008).

## Definition of Intellectual Capital

This study reviews some of the significant extant literature on intellectual capital and displays the definitions of it in a way that provides a useful understanding of what is the concept and movement. As there has not been a solidarity upon a universal intellectual capital definition yet, it's essential to be familiar with all of its definitions for the aim of fully comprehending and drawing a big picture of intellectual capital.

In order to look at it from a broad perspective, first intangible assets need to be understood. The concept of intangible assets constitutes an umbrella above intellectual capital. The definition of an intangible asset can be summarized as "knowledge that can be converted into profit which help organizations generating value and accordingly a claim to future benefits that does not have a physical or financial (a stock or a bond) embodiment" (Lev, 2001: 5; Sullivan, 2000: 5). Firms obtain value from this profit generated from the sale of goods or services, and that firms depend on intangibles such as reputation, customer loyalty, name recognition, leadership, and standard setting, and these are vitally dependent upon human capital to ensure repeat business (Choong, 2008).

Intellectual capital is generally defined as the intellectual material – knowledge, information, intellectual property, experience – that can be put to use to create wealth (Stewart, 1997). The creator of this definition;

Stewart (1998) presents intellectual capital as; the sum of all the knowledge that all the employees of a company have – knowledge, information, intellectual property and experience base and which can be put to use for the creation wealth, giving it a competitive advantage (Stewart, 1998: 7). Similiarly, Bontis (1998) considers that intellectual capital possesses intellectual attributes that can contribute to the value of a firm (Choong, 2008). Further, Bontis, Dragonetti, Jacobsen and Roos (1999) define intellectual capital as "the quite simple the collection of intangible resources and their flows", intangible resources is "any factor that contributes to the value generating processes of the company" (Kaufmann and Schneider, 2004). Brooking (1997) identifies intellectual capital as "market assets," "human-centered assets," "intellectual property assets," and "infrastructure assets" that when combined with an organization's other productive resources will eventually lead to value creation (Choong, 2008). Choong (2008) discusses, Edvinsson's (1997) presumption similar to that of Brooking's, that intellectual capital is not an objective thing, but is a relationship issue and a debt item, which is borrowed from the customers and employees and only by combining intellectual capital with these items, an organization can become more productive (Choong, 2008). According to International Federation of Accountants (1998) intellectual capital can be thought of as the knowledge-based equity of a company (Tan, Plowman and Hancock, 2008). Choong (2008) also refers to the study of Boudreau and Ramstad (1997) who consider that intellectual capital is closely related to human resource management that is needed by the organization to provide the necessary impetus for future development and growth (Choong, 2008).

Edvinsson and Malone make a metaphor in defining the intellectual capital; a tree, whose life depends on its roots, which are underground. Similiarly, the success of a company depends on its intellectual capital, which is also a hidden resource identified as an intangible. Hence, in their notion of intellectual capital, Edvinsson and Malone (1999) include – among other factors – those of knowledge, skills, inventive, and capacity of the employees to perform their tasks, as well as equipment, programs, databases, trademarks, and relations with customers (Lavanderos, 2008). Davenport and Prusak (1997) relates intellectual capital with technology, technological changes, and things associated with the management of information technology (IT). The ability of an organization that can utilize technology to manage and process information will be the one that has the capability to employ intellectual capital into good use (Choong, 2008).

Rastogi (2003) brings out the description of, "intellectual capital may properly be viewed as the holistic or meta-level capability of an enterprise to co-ordinate, orchestrate, and deploy its knowledge resources towards creating value in pursuit of its future vision" (Kaufmann and Schneider, 2004). A related definition comes from Lev (2001) and Daum (2002) stating that intellectual capital cannot come to appear by itself but it is a result depending upon the interaction of the network effect of other assets and the use of human, organizational, intellectual resources (Kaufmann and Schneider, 2004). Very similarly Mouritsen et al. (2004) indicate that IC mobilizes "things" such as employees, customers, IT, managerial work and knowledge. They add, "IC cannot stand by itself as it merely provides a mechanism that allows the various assets to be bonded together in the productive process of the firm" (Choong, 2008). Lev (2001) moreover claims that an intangible asset is a claim to future wich does not have any physical or financial appearance (Kaufmann and Schneider, 2004). Accounting researcher, Ordones de Pablos (2003), presents the description; "A broad definition of intellectual capital states that it is the difference between the company's market value and its book value. Knowledge based resources that contribute to the sustained competitive advantage of the firm form intellectual capital" (Kaufmann and Schneider, 2004). Non-accounting researchers define "intellectual capital" as the "difference between the firm's market value and its book value of entity" (Edvinsson and Malone, 1997; Stewart, 1997; Sveiby, 1997; Mouritsen et al., 2001). Instead according to accounting researchers, the difference between the market value of the enterprise and the book value of the entity's identifiable assets is defined as "goodwill." Goodwill is also known as "intangible assets" (Choong, 2008). Sullivan (2000) indicates intangibles as "knowledge that can be converted into profit." and Lev (2001) claims that "An intangible asset is a claim to future benefits" (Sullivan, 2000: 228; Kaufmann and Schneider, 2004). Lev and some other researchers use the notion of intangibles, though the term intellectual capital is often regarded as synonymous to intangible assets, the definition of OECD makes an appropriate distinction by locating intellectual capital as a subset of intangible assets of an organization. As a support to this distinction between the two concepts, reputation is an item of intangible nature that does not form part of the firm's intellectual capital but may constitute part of its outcome (Guthrie and Petty, 2000). Yet some authors use the two notions as synonymous but there is a consensus in the literature that the intangibles form an umbrella above the intellectual capital concept. Also the distinction between intellectual capital and knowledge management seems unclear, thus knowledge management, as a function, describes the act of managing the intellectual capital (Petty and Guthrie, 2000).

Lvanderos (2008) defines intellectual capital in agreement with the initial notions as the sum of all the knowledge (Stewart, 1998; Sullivan, 2000), which is owned by all the employees of a company and provide this one with a competitive advantage, or to put in other words, it is intellectual material such as knowledge, information, intellectual property and experience (Bontis, 1998), of which companies can take advantage in order to create wealth (Lavanderos, 2008). Andreou et al. (2007, p. 53) state that the business enterprise in this knowledge era has a need to become "intelligent" about its environment to gain knowledge from its environment and subsequently value its intangible resources. They argue that in order for an enterprise to become "intelligent" it is necessary for it to scrutinize its business processes/functions, codify them to facilitate the modeling of business activities, and provide definitions, attributes and constraints of business intelligence that align with the performance of the enterprise (Choong, 2008). Chong (2008) noted the similarities in the definition of intellectual capital by Lev (2001), Daum (2002), Rastogi (2003) and Mouritsen et al. (2004). It appears to have two things in common; the first is that, intangible cannot stand by itself, and hence, it cannot be valued separately from other assets; and the second likeness is that intellectual capital is the result of the network effect of utilizing various intellectual, human, capital and organizational resources. (Choong, 2008).

Further, regarding to all of the definitions presented in this study intellectual capital can be summarized as the accumulation of all information, knowledge, wisdom, experience, social and cultural interactions of an organization - rather than only the employees, internalized through the structural routines, processes, systems (Bontis, Dragonetti, Jacobsen and Roos, 1999; Andreou et al., 2007; Mouritsen et al., 2004) for the aim of creating an "intelligent" organization which generates value and competitive advantage (Petty and Guthrie, 2000; Choo and Bontis, 2002; Edvinsson and Malone, 1997; Ordones de Pablos, 2003; Stewart, 1998) in the market.

## Categorization of Intellectual Capital

Numerous groups, accounting professions and researchers have attempted to categorize intangibles. Categorization enables to order the systematic organization of a magnitude of possibilities into a set of class consisting of a coherent number of items (Choong, 2008). Following the big picture drawn by the definitions in the literature the categorization of the intellectual capital discovering the content and scope of it will serve consistently to the aim of exploring and analyzing "what is in the domain of the intellectual capital which has the potential to create competitive advantage for the organizations?" Choong (2008) states that the categorization indicates a better way in the description of what intellectual capital is, in comparison to using the definition approach. There are two reasons for this. First, intellectual capital is "invisible" (it has no physical appearance), that's why it is much harder to define than many other items. Second, the study of intellectual capital is relatively new and evolving, and it is hard to isolate the range of activities associated with it that can be defined (Choong, 2008).

Sveiby was one of the pioneers in this field. But broadened his classification to the categorization of intangibles, which are; employee competence, internal structure, and external structure. External structure concerns customer and supplier relations. Internal structure consists of patents, concepts, computer and administrative systems. The corporate culture of the company also belongs to the internal structure (Sveiby, 2001).

Lev (2001) states that intellectual assets consist of:
1) Innovation (discovery or knowledge);
2) Human resources; and
3) Organizational practices (capital) (Choong, 2008).

Marr and Chatzkel (2004) find that the researchers on intangibles often classify them into:
1) Human capital (employees' skills, talent and knowledge);
2) Information capital (information systems, databases and computer systems); and
3) Organization capital (culture, leadership, employee alignment, teamwork).
They conclude that in general, intangible assets are a collection of knowledge, intellectual and revenue generating resources (Choong, 2008).

As we proceed it will be obvious that none of the categorizations are apart from each other, though the notions are different the meaning lying behind them are very similar. Now that the categories of the umbrella sheltering intellectual capital has been specified, it's appropriate to move on to explore intellectual capital specifically.

The Organisation for Economic Co-operation and Development (OECD, 1999) describes intellectual capital as “the economic value of two categories of intangible assets of a company: organisational (structural) capital; and human capital (Guthrie and Petty, 2000). Though intellectual capital is generally classified into three dimensions there are also studies that classify it into two or further more into four dimensions. (Edvinsson and Malone, 1997; Stewart, 1997).

Sveiby (1997) is the first from the non-accounting perspective to propose the classification of intellectual capital, and he concludes that intangibles can be categorized into three sub-categories:
1) Employee (individual) competence;
2) Internal structure; and
3) External structure (Sveiby, 1997).

Edvinsson and Malone (1997), Bontis (1998), and Sullivan (1998) have adopted the similar three group categorizations of Sveiby(1997), but they termed these sub- categories as:
(1) Human capital;
(2) Organizational capital; and
(3) Customer capital (Edvinsson and Malone, 1997; Bontis, 1998; Sullivan, 1998).

The Measuring Intangibles to Understand and Improve Innovation Management – MERITUM (2002) for the measurement of intangibles within the firm, the outcome of the MERITUM Project, have in many ways adopted the IC methodology of Sveiby (1997) as well; the classification includes three categories of intellectual capital:
1) Human resources;
2) Structural resources; and
3) Relational resources (Guthrie and Petty, 2000).

Stewart (1998) accepted Sveiby’s categorization of the three sub-categories but instead of organizational capital he used the term structural capital (Stewart, 1998). Mouritsen et al. (2002), and Pablos (2003) separately used the same three-category classifications of intellectual capital as Sveiby and the above authors presented solidarity on, though, Pablos named the sub-category of “customer capital” as “relational capital” (Choong, 2008). Petty and Guthrie (2000) accepted the categorization of the OECD, accepting only two out of the three categories of Sveiby and these are human and organizational capitals (Guthrie and Petty, 2000). Roos et al. (1997) similarly classifies intellectual capital into structural and human capital which represents “thinking” and “non thinking” assets. This distinction acknowledges different management methods for human and structural capital (Tan, Plowman and Hancock,2008). Brookings (1996) on the other hand identified four components of intellectual capital:
1) Market,
2) Human-centerd,
3) Intellectual property; and
4) Infrastructure assets.
Tan, Plowman and Hancock (2008) argue that the difference between these classification systems is that they assume different levels of aggregation of the elements of intellectual capital (Tan et al., 2008).

Following the identification and classification of intellectual capital assets, during 2002 and 2003 a group of academics and experts developed a series of workshops at the Spanish Knowledge Society Research Center in Madrid. In those workshops, based on previous literature as well as on professional experience, a model of intellectual capital – called Intellectus (CIC, 2003) – was developed. It includes five components:
1) Human capital: indicates the tacit or explicit knowledge and the ability to create that knowledge possessed by the employees,
2) Technological capital: specifies the development of the activities and functions of the technical system of the organization directly linked with the combinatorial application of the knowledge,
3) Organizational capital: refers to the combination of explicit and implicit, formal and informal knowledge which in an effective and efficient way structures and develops the organizational activity of the firm,
4) Business capital: states the value to the organization of the relationships which it maintains with the main agents connected with its basic business processes – customers, suppliers, allies, etc; and
5) Social capital: as the value to the organization of the relationships which it maintains with other social agents and its surroundings (Martin-de-Castro et al., 2006).

American Financial Accounting Standards Board (FASB), classifies intellectual capital to more specific seven categories; technology, customer, market, workforce, contract, organization, and statutory-based assets

(Kaufmann and Schneider, 2004). “Intangible Assets in Accounting” of the Schmalenbach Society for Business identifies innovation capital, human capital, customer capital, supplier capital, investor capital, process capital, and location capital (Kaufmann and Schneider, 2004).

Although Marr et al. (2003) reviewed the literature on the measurement of intellectual assets, and identified that intellectual can be categorized into three main categories:
1) Strategy;
2) Influencing behavior; and
3) External validation. (Choong, 2008)
Marr and Adams (2004), according to the classifications of Sveiby (1997) Edvinsson and Malone (1997); Bontis, (1998); Sullivan (1998) and MERITUM (2002) find that there has been a general convergence towards a three-grouped framework consisting of:
1) Human capital;
2) Organizational (or structural) capital; and
3) Relational capital (Marr and Adams, 2004).

Rastogi (2003) concludes that a categorization of IC is hardly possible. However, he states that IC is the result of interaction between a firm’s knowledge management, its social capital and human capital (Kaufmann and Schneider, 2004). Bukh et al. (2001) compare various taxonomies of IC and conclude that they all have three things in common:
1) The connection to employees;
2) The connection to processes and structures, and;
3) The services and value added activities connected to customers (Chong, 2008).

In this study the categorization of intellectual capital into three sub-categories is considered. Those sub categories are;
1) Human capital;
2) Organizational capital;
3) Relational capital.
Hence the description of these three categories will be presented.

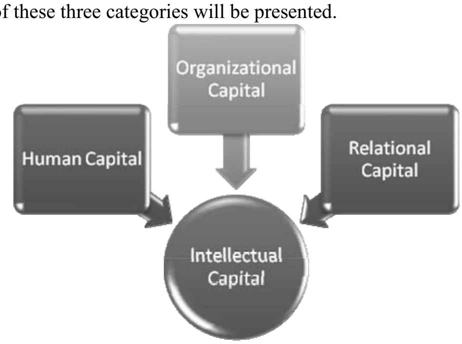



**Figure 1. The categorization of intellectual capital.**

Human Capital; is the knowledge, experience, capabilities and skills that are related with the employees and which are used through them within the organization (Subramaniam and Youndt, 2005: 451; Hsu and Fang, 2008: 2; Cuganesan, 2005: 358). The two determinants of the human capital are; the capabilities of the employees in the scope of both the intangible and tangible assets’ production, the second determinant is the commitment of the employees to the organization (Y.-S. Chen, 2006: 1325) . The reason why the employees’ commitment (ie. loyalty) is important, is because, though some of the authors consider that human capital is part of intellectual capital, technically and legally, they are not properties that can be owned by the organization unlike other forms of intelectual capital. Hence, it is their decision to stay and generate value for the firm or to leave and generate value for another firm (Edvinsson and Malone, 1997; Stewart, 1998; Y.-S. Chen,2006). From a more broad perspective human capital is concerned with the skills, knowledge, innovativeness, capabilities, know-how, education and overall competence of the employees (Edvinsson and Malone, 1997; Sullivan, 1999; Seetharaman et al., 2004). Tovstiga and Tulugurova (2007) claims that human capital is constituted of three main attributes which are; competence (knowledge, skill sets, and experiential knowledge), attitude (level of motivation, behavioral patterns) and intellectual agility (innovation, creativity, flexibility, adaptability) of the enterprise's employees (Tovstiga and Tulugurova, 2007: 399). Human capital represents the stock of knowledge within an organization rather than in the minds of individual employees since these employees work for that firm and help generating, knowledge and ideas for that firm (Seethraman et al., 2004). Human capital interacts with both organizational and relational capital and represents the goods and services employees produce that bring revenues when there is an investment of their knowledge, skills, and other abilities (Isaac, Herremans and Klein, 2009). Sveiby (2001) defines human capital as the people's capacity to act in various situations and he claims that it includes skills, education, experience, values and motivation (Sveiby, 2001). Kong and Prior (2008) present the ideas of Bontis (2002) as; human capital is important to organizations as a source of innovation and strategic renewal. Thus, a higher level of human capital is often associated with greater productivity and higher incomes or compensation for employees (Kong and Prior, 2008). The value of all the collective human capital of the firm is hard to estimate but the million dollar insurance policies purchased on a key employee of the firm and high compensation packages (Seetharaman et al., 2004).

Organizational capital dimension; is identified with technologies and supporting systems that help employees to do their jobs and ultimately create revenues for the organization that result in corporate wealth. Organizational capital includes databases, technical and communication systems, policies, and other support mechanisms (Edvinsson and Malone, 1997; Kaufmann and Schneider, 2004; Ordonez de Pablos, 2003; Isaac, Herremans and Klein, 2009). Subramaniam and Youndt (2005) consider organizational capital as the institutionalized knowledge and codified experience residing within and utilized through databases, patents, manuals, structures, systems, and processes similar to other studies in the literature. It consists of three main aspects; relationships, relational networks including also the external players (involving strategic networks, alliances, relationships with customers and other key stakeholders, regulatory institutions), organizational routines, attributes, explicit codified knowledge (databases, routines, infrastructure, processes and culture), and renewal and development (research and development, investments in organizational learning) (Tovstiga and Tulugurova, 2007: 699). It is regarded as the most complex category of the intellectual capital and it has undergone several changes, and Choong (2008) claims that recently, some researchers have suggested it to include culture, innovation and process (Choong, 2008). The pool of knowledge that remains in an organization after individuals within the organization have left, represents the fundamental core of organizational capital (Kong and Prior, 2008), because organizational capital mentioned also as structural capital is the attribute integrating all the knowledge, skills, experiences, competences to the organization and help it to own all of those aspects, as Subramaniam and Youndt (2005) mention Daft and Weick's observation as, "Individuals come and go, but organizations preserve knowledge over time" (Subramaniam and Youndt, 2005: 351). Organizational capital is the supportive infrastructure for human and relational capital since in the absence of it both of the other capitals are not embedded in the organization. It includes all of the non-human storehouses of knowledge in organizations such as databases, process manuals, strategies, routines, organizational culture, publications and copyrights which creates value for organizations, thus adding to the organizations' material value (Ordonez de Pablos, 2004; Kong and Prior, 2008).

Relational capital can be explained as the flow of knowledge within and to the outside of the organization through the relational network constituted in and around the organization. Subramaniam and Youndt (2005) define relational capital as is the knowledge embedded within, available through, and utilized by interactions among individuals and their networks of interrelationships and term it as social capital (Subramaniam and Youndt, 2005: 451). Relational capital can be referred to in different names through the literature. Johansson et al. (2001), Sanchez et al. (2000), Stewart (1998), Edvinsson (1997) consider it as customer capital; Subramaniam and Youndt (2005), refer to relational capital as social capital, and Ordonez de Pablos (2003) identifies it as stakeholders. In the basis even there are different names of it, relational capital represents a dimension of intellectual capital that is comprised of connections with others within or outside the organization that lead to organizational value generation (Isaac, Herremans and Klein, 2009). It includes customer relationships, license agreements, brand value, trademarks, cooperation, relationship with customers and suppliers, firm reputation, organizational awareness, distribution channels and customer loyalty (Cuganesan, 2005: 358; Seetharaman et al., 2004: 524; Kong and Prior, 2008: 120). Wu et al. (2008) mentioned the three dimensions of organizational capital termed as social capital, proposed by Nahapiet and Ghoshal (1998). The first dimension is the structural dimension, comprising social interactions or network ties, the overall pattern of connections among all actors. The second dimension of social capital according to them is the relational dimension, which refers to assets that are rooted in relationships, such as trust and trustworthiness. The cognitive dimension is the third dimension of social capital, which refers to those resources providing shared representations, interpretations, and systems of meaning among parties (Wu et al., 2008: 266). Relational capital works more like organizational capital then human capital. Since social capital stems from norms for collaboration, interaction, and the sharing of ideas, it tends to be largely preserved within organizations without any dependence on changes in specific individual actors (Subramaniam and Youndt, 2005: 452). Relational capital is important to an organization because it acts as a multiplying element that creates value for the organization by connecting all IC components with other external stakeholders (Ordonez de Pablos, 2004).

Despite of all the discussions, Kaufmann and Schneider (2004) think that, in the end, all these categorizations stay at a very abstract level and that they do not offer direct guidance on the management of intangibles (Kaufmann and Schneider, 2004).

## Measurement and Reporting of Intellectual Capital

Lord Kelvin stated that; "When you can measure what you are speaking about and express it in numbers, you know something about it; but when you cannot measure, when you cannot express it in numbers, your knowledge is unsatisfactory." The statement stressed in the works of Tan et al. (2008) and that of Leibowitz et al. (2000) stresses the importance of measuring concepts. The complexity of the intellectual capital's classification put limitations to the measurement and reporting of the intangible assets. The restrictions of traditional accounting practices such as existing financial reporting models lead to the evolution of new measurement and reporting models having the aim of synthesizing the financial and non-financial value-generating factors of the enterprise into one external report (Guthrie and Petty, 2000). The lack of a generally accepted methodology for valuing intangible assets has led to numerous efforts (Tan, Plowman and Hancock, 2008; Leibowitz and Ching, 2000).

Sveiby (2002) suggested four categories for the measurement approaches of intangibles. Thus these categories are an extension of the classifications suggested by Luthy (1998) and Williams (2000), argured by the work of Tan et al. (2008). These categories are:
1) Direct intellectual capital (DIC) methods or Dollar valuation Methods of Intellectual Capital: This method estimates the dollar value of intangible assets by identifying its various components ( Sveiby, 2002; Tan, Plowman and Hancock, 2008).
2) Market capitalization methods (MCM): MCM calculates the difference between a company's market capitalization and the book value of its shareholders' equity as the value of its intellectual capital. It's more of an accounting model (Sveiby, 2002).
3) Return-on-assets (ROA) methods: ROA method is the average pre-tax earnings of a company for a period of time divided by the average tangible assets of the company. The result is a company ROA that is then compared with its industry average. The difference is multiplied by the company's average tangible assets to calculate an average annual earnings from the intangibles. Dividing the above average earnings by the company's average cost of capital or an interest rate, one can derive an estimate of the value of its intangible assets or IC (Sveiby, 2002).
4) Scorecard methods (SCM) or Non- Dollar Valuation of Intellectual Capital: The various components of intangible assets or IC are identified and indicators and indices are generated and reported in scorecards or as graphs. SCM methods are similar to DIC methods, except that no estimate is made of the dollar value of the intangible assets (Sveiby, 2002; Tan, Plowman and Hancock, 2008).

In this study, non-dollar valuation of intellectual capital will be explained since it is the most accepted and studied measurement classification.

#### Non-Dollar Valuation of Intellectual Capital

Balanced Scorecard model proposed by Kaplan and Norton (1992) is a pioneer in the measurement of intellectual capital without converting it to financial properties or dollar value. It is not a model specifically created for measuring the intellectual capital of an organization; rather, it tries to be a corporate management system and measure the results obtained at the heart of the organization, integrating for the first time the concept of intangible assets (Canizares, Munoz and Guzman, 2007: 411). It represents an important advance from the previous models of management as it considers that, being based exclusively on indicators of a financial kind, its base is absolutely obsolete. It measures the organizational performance across four dependent perspectives. The first is financial, which includes the cash-flows, product/service profitability, profitability of capitals, representing the final objective of the managerial result. The second is customer perspective that has driver indicators as the quality of the relationship with the customer, and the reputation of the company among its competitors and the output indicators as the results from the financial perspective (market quota, customer loyalty etc.) to determine the values related to the customers that increase the competitiveness of the organization. The third is internal business processes which propose an analysis of the internal processes (innovation, operations, post-sale services) in a way that makes them essential in the value chain, the aim is the increase of financial yield and customer satisfaction. Finally the last perspective is learning and growth define a group of values that enable improvement and continuous learning within the company and they are; capacity and competition of employees, systems of information, culture-climate-motivation for learning and action (Tan, Plowman and Hancock, 2008: 592; Canizares, Munoz and Guzman, 2007: 412). The BSC represents a set of cause-and-effect relationships amongst output measures and performance drivers. It provides for the control of intangibles while simultaneously monitoring financial results. The BSC provides the analysis of the organization from four important perspectives for the management which are (Tan, Plowman and Hancock, 2008: 592):

1) How do customers recognize the company?
2) What must the company succeed at?
3) Can the company continue to improve and create value?
4) How does the company view the shareholders?

Balanced Score Card method, sees that there are three groups of strategic individuals with different aims. These are the customers, who demand quality in the products and services offered, the investors, who want the value of the company to increase and the personnel of the company, who look for attractive pay packages and job security (Tan, Plowman and Hancock, 2008: 592).

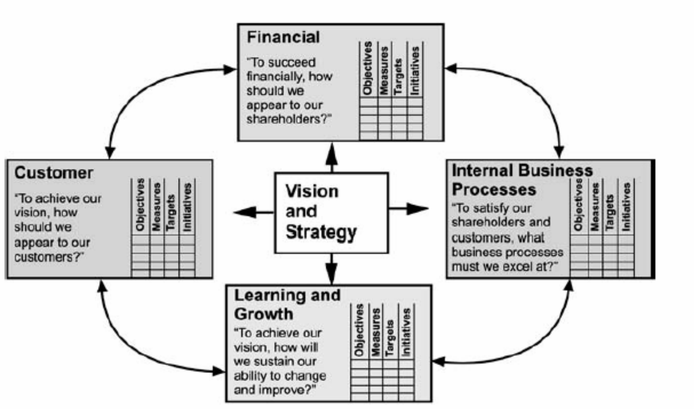



**Figure 2. The Balanced Score Card Model of Kaplan and Norton**
**Source: Canizares, Munoz and Guzman, 2007**

Another approach to measuring and reporting intellectual capital is Karl Erik Sveiby's "Intangible Assets Monitor" used by the Swedish company Celmi and it includes indicators referring to the growth, renewal, efficiency, stability, and risk relating to each of the three categories of intangibles (employee competence, internal structure, and external structure) (Sveiby, 1997; Kaufmann and Schneider, 2004). The intangible assets show the difference between the countable value and the market value of an organization. The measurement of these assets is a two-way process:

(1) toward the exterior, to inform the external agents with links to the company (clients, shareholders, suppliers);
(2) toward the interior, to inform the directors about the evolution of the company(Canizares, Munoz and Guzman, 2007).

Sveiby (1997) differentiates the intangible assets into three categories. *Competence indicators* which include competition between professionals in the organization, *internal structure indicator,* representing the structured knowledge of the organization like patents, models, informative systems, culture, and the group of people whose main activity is the maintenance of this structure and *external structure indicators* which are all the relationships with external agents such as customers, suppliers, the brand, and the image of the company. All of these intangible assets fall under the three types of categories offered by Sveiby; indicators of growth and innovation, indicators of efficiency and indicators of stability (Canizares, Munoz and Guzman, 2007; Kaufmann and Schneider, 2004; Sveiby, 1997).

| | Competence | Internal structure | External structure |
|---|---|---|---|
| Growth/renewal indicators | Number of years in the profession<br>Level of education<br>Training and education costs<br>Marking<br>Competence turnover<br>Competence-enhancing – customers | Investment in new methods and systems<br>Investment in informational systems<br>Customer contribution to the inner structure<br>Providing new services and/or products<br>New processes installed | Profitability per client/customer<br>Organic growth<br>Sales to new customers |
| Efficiency indicators | Professionals' rate/proportion<br>Added value per professional<br>Added value per employee<br>Profit per professional<br>Profit per employee | Rate of supporting personal<br>Sales per supportive person | Success/failure index<br>Profit per client<br>Sales per client |
| Stability indicators | Professionals turnover<br>Relative pay<br>Seniority | Age of the organization<br>Support staff turnover<br>Rookie ratio<br>Seniority | Proportion of great customers<br>Customer satisfaction index<br>Customers' loyalty ratio<br>Antiquity structure<br>Repetition frequency |

**Source:** Sveiby (1997)

**Figure 3. The intangible assets monitor of Sveiby.**
**Source: Canizares, Munoz and Guzman, 2007**

Another important measure is the Skandia Navigator model which is the first dynamic intellectual capital model. Its main developer was Leif Edvinsson. It appeared for the first time in 1992 in the memory of the company Skandia (Canizares, Munoz and Guzman, 2007). It's based on the difference between the value of the companies' assets and those of the market. This implies that a series of intangible properties exist, which are underestimated by the market as future bank flows (Canizares, Munoz and Guzman, 2007). This reporting technique utilises 112 metrics to measure five areas of focus (Edvinsson and Malone, 1997: 68). The five areas are; financial, customer, human, process and renewal and development. The financial perspective focuses mainly on the company's balance sheet that deals with the past activities of the firm. Customer, human and the process focus constitute the intellectual capital of a firm and represent the present stage of the firm. It is particularly impressive in recognizing the role of customer capital in creating value, and how the nature of customer relationships has changed (Tan, Plowman, Hancock, 2008; Canizares, Munoz and Guzman, 2007). Renewal and development perspective, as their contribution to organizational value has not been previously attempted and is the foundation that underpins the company's future (Tan, Plowman, Hancock, 2008; Canizares, Munoz and Guzman, 2007). The 112 indices are computed using direct counts, dollar amounts, and percentages or survey results as appropriate. Some examples of these indices are: Income per employee, value added per customer and invoicing per employee (Tan, Plowman, Hancock, 2008). Skandia's efforts on the measurement of a company's intangible assets has motivated others to search for "what creates value for organizations" (Tan, Plowman and Hancock, 2008).

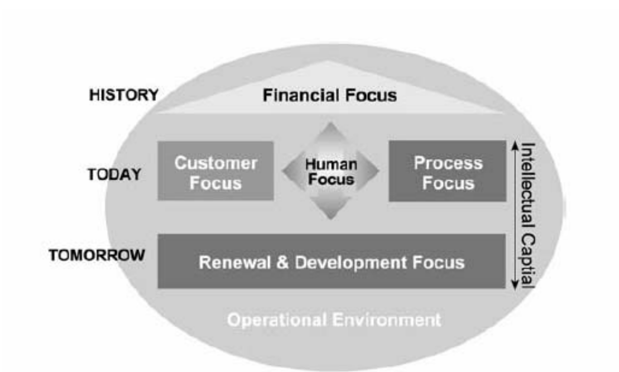



**Figure 4. The Skandia Navigator.**
**Source: Canizares, Munoz and Guzman, 2007**

Kaufmann and Schneider (2004) state that researchers have developed various models to measure and manage intangibles and these models were constructed for different purposes; some for external reporting and some to manage intangible resources within a firm. The authors conclude that model constructors were based on four categories of thought (Choong, 2008). The first category believes that management has a primary responsibility to transform human capital into structural capital (Edvinsson, 1997). They try to provide supplementary information to the annual financial report, and focus on agents within the firm. The second category is based on Sveiby's (1997) model known as the Intangible Asset Monitor, which includes information about growth, renewal, efficiency, stability, and risk relating to each category of intangibles (employee competence, internal structure and external structure). The third category is the model advocated by Stewart (1997). Stewart created an IC navigator in the form of a radar chart to visualize and measure the intangibles in a company. Here, each of the three types of intangibles (human capital, customer capital, and structural capital) is one axis (Stewart, 1998).
This category focuses in measuring each category of intangibles (human, customer, and structural capitals) and enable the intangibles reported to be compared with other firms. The fourth category of thought relates to the balanced scorecard (BSC) model developed by Kaplan and Norton (1996). In the latter model while the four perspectives (financials, customers, internal processes, and learning and growth) are not directly related to intangibles, they provide strategic company performance measurement in a holistic way that goes beyond the financial perspective (Choong, 2008: 625).

To answer the question why organizations are seeking to measure intellectual capital, Marr et al. (2003) identified five main reasons through the literature. The reasons are:
1) to help organizations formulate their strategy;
2) to assess strategy execution;
3) to assist in diversification and expansion decisions;
4) to use these as a basis for compensation; and finally
5) to communicate measures to external stakeholders. (Marr, Gray, Neely, 2003)

Despite all the above models and frameworks represent important advances within the intellectual capital discipline; they silence the problematic nature of utilizing IC to create value. IC inter-relationships and their consequences for value creation are unstable and precarious, being contingent upon the manner of their deployment and use within organizational processes (Cuganesan, 2005).

## Competitive Advantage in Relation to Intellectual Capital

Sustained competitive advantage can be obtained when a firm develops a distinctive core competency (Hoffman et al., 2006: 140). What the literature appears to be suggesting is that competitive advantage increasingly is achieved by those firms that succeed in mobilizing their intangible assets in the form of knowledge, technological skills, experience, and strategic capabilities toward creating new processes and product or service offerings (Tovstiga and Tulugurova, 2007: 697). Hence the successful mobilization of these intangible assets may be identified as a distinctive core competency for the organization. The most common theory that examines competitive advantage of the firms, is resource based theory. We know from Schumpeter that resources can be important sources of innovation through new or different combinations of new or already existing resources (Schumpeter, 1934) and through their superior abilities (Hoffman et al., 2006: 140). While this is the conceptual basis of a framework that is developed to connect intellectual capital and the organization's environment (socio-political, economic and technological), the resource based theory of the firm, even more specifically the knowledge based theory where the firm's strategic knowledge is seen as the fundamental resource, identifies knowledge as the key competitive resource of the firm (Tovstiga and Tulugurova, 2007: 697). Tovstiga and Tulugurova (2007) view intellectual capital in its various forms as the primary resource available to these entrepreneurial endeavors.

What is meant by competitive advantage? Competitive advantage is mainly used to differentiate company performance in the profit-making sector. Competitive advantage is a concept that means much more than the financial performance and shareholder value; these are both a measurement at a moment in time, usually short-term. In today's globally competitive environment which requires, speed, dynamic capabilities, fast responsiveness and flexibility the objective of the organizations shifted from profit maximization to value maximization ( Freeman, 2001). Hence the value of the firm that is generated through the intangible assets and more specifically through the intellectual capital carries more importance than financial profit. Competitive advantage is built slowly over time from a number of different aspects: one of the most important is organizational image and integrity (Freeman,2001). An independent consultant Olivia Freeman

(2001) gave rise to the issue, how to gain competitive advantage for organizations by presenting the ideas of Professor Michael E. Porter from Harvard Business School who has been the guru of competitive strategy since 1980, when he published his classic book on the subject. Five years later, he took this a stage further and wrote a book called *Competitive Advantage*, which explains 'how a firm can actually create and sustain a competitive advantage in its industry'. Sustain is a key word. The professor claims that 'There are two basic types of competitive advantage: cost leadership and differentiation'. Among these two types of competitive advantage the factors that may lead to reach it are; sustained revenue, innovation and new product development/first to market, brand and reputation, advertising, media coverage, customer needs, customer service/satisfaction, employee relations, acquisitions and mergers, regulatory issues, political correctness, IT services that affect customer service (Freeman, 2001: 39). Mentioned by the Professor Porter, the differentiation is an essential aspect in the owning of competitive advantage. But to differentiate, you need to know what you are being different from and this would lead one to believe that the ability to monitor competitor activity and to provide accurate up-to-date knowledge would be top level strategic skills in any organization (Freeman, 2001: 39). The study of Hoffman et al. (2006) refers to Prahalad and Hammel's (1990) observation about the core competency becoming a distinctive core competency -meaning that the firm differentiates from its competitors, not only when that company does that something very well (a core competency) but when the company does that something better than anyone else in the industry (a distinctive core competency) (Hoffman et al., 2006: 140). This competency then becomes a competitive resource, and if barriers exist that limit other firms' access to the resource, it becomes a long-term source of economic rents (Hoffman et al., 2006: 140).

There is an extensive literature that examines various enterprise-specific factors involved in creating a position of competitive advantage for the firm, and the complex interplay between the firm's internal organizational factors and environmental factors. Research evidence suggests that while environmental contexts can be very influential, they do not necessarily outweigh a number of key internal factors that can be directly influenced by the enterprise, while those in the firm's environment generally cannot ( Hoffman et al., 2006: 140). Hoffman et al. (2006) argues the claims of Sanchez and McKinley (1998) who suggest that "whether or not environmental regulation inhibits or promotes product innovation seems to depend at least in part on certain internal features of an organization" (Hoffman et al., 2006: 140). From these arguments it's understood that to obtain a sustainable competitive advantage, organizations should place more importance on the internal factors rather than the external environmental conditions. The external conditions can only be controlled up to a point and even sometimes they cannot be controlled at all. On the other hand the internal resources, internal assets of the organizations are under the governance of organization itself. Accordingly the main vision of the organizations should be on the efforts to influence the internal organizational factors.

The impetus for organizations to build and sustain competitive advantage is well recognized in the strategic management literature (Kong and Prior, 2008). The utilization of knowledge has been a topic of interest in the strategic management literature, with some scholars suggesting that it is linked with the creation and maintenance of competitive advantage (Nonaka, 1994). One form of conceptualizing knowledge is through the study of intellectual capital (Roos et al., 1997; Bontis, 1998; Kong and Prior, 2008). As physical assets and financial capital are no longer the primary resources that facilitate competitive advantage in a knowledge based society, knowledge becomes the only means to competitive advantage (Kaplan and Norton, 2001; Kong and Prior, 2008). In examining the role of knowledge in supporting competitive advantage across the various disciplines, the possession of unique knowledge sets is seen as determining the extent to which competitive advantage can be sustained (Silvi and Cuganesan, 2006). The specificity of the knowledge possessed thus represents an important influence in the ability of the organization to achieve and maintain higher levels of performance in front of its peers, on the grounds of its greater potential to provide competitive differentiation and the difficulties associated with its imitation and replication elsewhere (Silvi and Cuganesan, 2006). The idea of competitive advantage is usually linked to extraordinary firm performance (Porter, 1985; Kong and Prior, 2008). The knowledge is not only the creation of people by themselves. Knowledge is a result of people's and groups' interaction which in the end provides the emerging of new organizational knowledge in the network. Since tacit knowledge is systematic when the knowledge is codified into routines, rules and activity procedures and the knowledge is codified into these routines, rules and procedures through structural capital, the tacit knowledge becomes systematic with the use of structural capital within the intellectual capital. What makes a tacit knowledge systematic and opens it up to the usage, application and diffusion is structural capital.

Achieving competitive advantage in all markets would appear to be an attractive goal, yet the diversity of different stakeholders' needs would seem to make this a difficult proposition. The appropriate deployment of intellectual capital can provide access to multiple market opportunities in all the organizations (Kong and

Prior, 2008). One important outcome of the explosion of computing power and connectivity in the last quarter of the 20th century is that it has as well redefined the role and economic importance of intangibles. Moreover, key intangible assets, such as know-how and high performance new business practices and new business models, now have the capability to be transferred rapidly around the world. It has also served to destabilize the old-world value-delivery model and create a wholesale disaggregation of the corporate value system. Value chains always had a limited life in competitive markets, but are now eroding much faster than in the past. Hence the critical importance of an effective "innovation machine" to keep one step ahead is understood. Continuous evolution and renewal of this capability is the main preoccupation of corporate strategy today (Eustace, 2003). The modern economy is characterized by mature markets for goods and services. As markets have become increasingly mature (commoditized), so firms have to compete harder for monopoly profits or comparative advantage (Eustace, 2003). All these factors force firms to deepen their search for new factors of differentiation and market leverage, not only in the "new economy" sectors but in the mature industries struggling to keep their business models evolving at least at the pace of the market (Eustace, 2003). Eustace states that, "A new market model is emerging – where sustainable value-creation is geared less to economies of scale than the exploitation of innovation, arbitrage and scope effects. Subtly, and incrementally over several decades, this has resulted in a fundamental shift in the corporate value system, away from physical and financial assets (now commoditized) towards the creative exploitation of a nexus of intangible assets, quasi-assets and competences – mainly in the form of distinctive capabilities deriving from knowledge intangibles – that have become essential ingredients of the economic production process" (Eustace, 2003).

## Conceptual Framework and Hypotheses

The competency literature contains a number of indicators as to what can be considered a competency or core capability. The essential components of these definitions are that it results from combining resources, that it contributes to competitive advantage, that the competency can be used to access multiple market opportunities, and the competency is able to be preserved (Teece et al., 1997; Kong and Prior, 2008). The three components of intellectual capital; human capital, organizational capital and relational capital can also be viewed as resources. The resources in the resource based view literature are defined as "anything which can be thought of as a strength or weakness of a given firm" (Priem and Butler, 2001). Some more specific definitions consider resources as being specific assets, or combinations of assets (Schumpeter, 1934) that own the property of being valuable, inimitable, non-substitutable and rare (Priem and Butler, 2001; Srivastava, Fahey and Christensen, 2001). That is the reason why when a distinctive core competency is obtained, it leads the organization to the competitive advantage because the competitors cannot imitate, substitute or transfer that specific organization's distinctive core competency easily. Lopez et al. (2006), define resources as; "any production factor that is ready for the company, which is to say that it can be controlled in a stable manner, even if it does not entail clear property rights" (Lopez et al., 2006: 325). The most accepted descriptions of resources consider both tangible and intangible assets as resources (Penrose, 1959; Teece et al., 1997; Kong and Prior, 2008). Knowledge management is seen as the process of managing the intellectual capital of an organization. Given, that in most cases, the economic and productive capacity of an organization "lies more in its intellectual and service capabilities than its hard assets" it is increasingly recognized that the performance of any organization, private- and public-sector, is substantially dependent upon the knowledge of its employees, the application of that knowledge to the structures of the organization, and its relationships (Silvi and Cuganesan 2006). Hence, intellectual capital, regarding its definition and categorization meets all of the conditions of being a resource which is; organization specific, inimitable, non-substitutable, rare and non-transferable. Intellectual capital provides the integration of the intangible assets that it includes within its component (human, organizational and relational capital) to the organization through the collaborative tasks it holds in its structure.

The creation and maintenance of human capital allows the organizations to develop new ideas and innovations through better-trained, more focused staff and higher employee morale (Kong and Prior, 2008). New ideas and new innovations mean new knowledge, new inputs to organizational memory and new sources of value generation. Kong and Prior (2008) position the words of Knight (1999) in their study saying: "…as investments are made in human capital, more competent and capable people develop better structural capital for an organization. Improved human capital and structural capital go on to create more productive external [relational] capital through the delivery of better products and services to high-value customers . . . a virtuous cycle begins its upward spiral into further organizational value and growth" (Kong and Prior, 2008). The specificity of the knowledge possessed thus represents an important influence in the ability of the organization to achieve and maintain higher levels of performance in front of its peers, on the grounds of its greater potential to provide competitive differentiation (Silvi and Cuganesan, 2006). Knowledge innovation is a key element in the creation of product value and economic growth in a knowledge-based economy (Hsu and Fang, 2008). In the discussion made by Hsu and Fang (2008), Baker (1992) reflects that high-quality employees are the most important factor for a firm in this economy. Managers train their employees to be knowledgeable workers, improve their overall quality, and increase organizational learning capability. Hsu and Fang get support from the ideas of Pfeffer (1994) who notes that the manner in which a firm retains and trains its best human resources is the most important competitive strategy within the knowledge economy context (Hsu and Fang, 2008). The more long-serving, experienced, and proven people are employed in an organizations, they provide the wisdom, and their wisdom is the key to future corporate success. In today's turbulent world it could be that the younger, open minded, and cavalier business brains are better equipped for information age companies. These people do not necessarily have conventional skills sets but they have the creative ability for the generation of new knowledge, new processes, new systems etc.

**Hypothesis 1a**: Human capital positively influences structural capital.
**Hypothesis 1 b:** Human capital positively influences relational capital.
**Hypothesis 1 c:** Human capital positively influences competitive advantage.

In examining the role of knowledge in supporting competitive advantage across the various disciplines, the possession of unique knowledge sets is seen as determining the extent to which competitive advantage can be sustained (Silvi and Cuganesan, 2006). The specificity of the knowledge possessed thus represents an important influence in the ability of the organization to achieve and maintain higher levels of performance in front of its peers, on the grounds of its greater potential to provide competitive differentiation and the difficulties associated with its imitation and replication elsewhere (Silvi and Cuganesan, 2006). The idea of competitive advantage is usually linked to extraordinary firm performance (Porter, 1985; Kong and Prior, 2008). The knowledge is not only the creation of people by themselves. Knowledge is a result of people's and groups' interaction which in the end provides the emerging of new organizational knowledge in the network. When the knowledge is codified into routines, rules and activity procedures the tacit knowledge becomes systematic with the use of structural capital within the intellectual capital. What makes a tacit knowledge systematic and opens it up to the usage, application and diffusion is structural capital (Kong and Prior, 2008). Therefore, following the cycle that; the knowledge possessed influences the ability to maintain higher levels of performance, performance is an indicator of competitive advantage in the strategic management literature and knowledge is embedded into the organization through structural capital. This discussion concludes that structural capital influences the achievement of competitive advantage. Similarly an information technology perspective emphasizes the development of infrastructure for a knowledge-based organization. IT applications allow firms to better capture, storage, retrieval and share documented knowledge (Silvi and Cuganesan, 2006). Specifically organizations are implementing decision support and expert systems, database management, on line document systems repository, internet, intranet and extranet applications in order to enable managers to route, share and distribute information and codify knowledge (Silvi and Cuganesan, 2006). Moreover, Lopez et al. (2006) focus to three main components of organizational capital; culture, structure and organizational learning. The first component contributes to the generation of value internally and externally. From an internal perspective; firms that are successful at obtaining productivity through their people generally have an organizational culture that supports and values the contribution of the employee. From an external point of view, organizations that have strong customer cultural values stay close to their customers, providing in timely market information, joint product development activities, and intense product loyalties (Lopez et al., 2006: 329). About the structure of the organization; the main issue is that the formal structure of the organization and its external links play an important role in innovation management and in how the competences and capabilities evolve. It can be deduced that the value of the structure will be based on its fit to the environment conditions (Lopez et al., 2006: 329). So, Lopez et al. (2006) conclude that, the structure is a necessary capability for the organization, and although it is difficult to imitate and to transfer, its duration can be variable and is susceptible to substitution, so it can be a source of competitive parity (Lopez et al., 2006: 329). Finally, Lopez et al. (2006) mentions the organizational learning as a source of sustainable competitive advantage. It is the ability of the company to manage and to mobilize its resources in a competitive response, and it is a key for firm adaptability, and makes learning a combinative capability (Lopez et al., 2006: 332). Thus organizational learning is a valuable organizational capability, difficult to imitate, to replace, and to transfer. Besides it has a prolonged life expectancy and it does not show difficulties for rent appropriation (Lopez et al., 2006: 332). To conclude, Lopez et al. (2006), state that organizational learning and culture show the highest potential for sustaining competitive advantage, though structure take risks of imitation and substitution by competitors, and their value to the firm is limited to a competitive parity (Lopez et al., 2006: 332).

**Hypothesis 2:** Organizational capital positively influences competitive advantage.

Specifically; relational capital enables the links between diverse groups and organizations, while also providing a rationale for continued inter and intra organizational relationships with a variety of stakeholders (Kong and Prior, 2008). Huang and Chang (2008) refer to Uzzi's (1996, 1997) statement that trust acts as the governance mechanism of embedded relationships. Trust is expressed as confidence in a partner not to exploit the vulnerability of the other party. Trust exists when one party has confidence in an exchange partner's reliability and integrity. Business networks with high embeddedness can develop trust and support a rich exchange of information among their members (Huang and Chang, 2008). Commitment concerns the future stability of a relationship and suggests a future orientation. Huang and Chang (2008) developed a framework; where "commitment" is defined as an implicit or explicit pledge of relational continuity between exchange partners and implies a willingness to make short-term sacrifices in the interest of longer-term benefits. Relationship commitment exists when an exchange partner believes that an ongoing relationship with another is so important as to warrant maximum efforts at maintaining it, according to Morgan and Hunt (1994) mentioned by Huang and Chang (2008). Huang and Chang (2008) presents also the ideas of Nielsen (1998) and Fujimoto (2003) suggested that closeness between partners and embedded ties are positively associated with a commitment to the relationship encouraging each party also found that an embedded tie encourages each party to make considerable commitments (Huang and Chang, 2008). The creation and maintenance of effective interactions, good relationships with the customers, suppliers, distributors, stakeholders, partners, investors and the government will increase the reputation, the credibility, customer satisfaction, government and financial support, brand awareness and customer/supplier loyalty of the organization. This will push the firm one step forward within its competitors. The maintenance of effective interactions and good relationships can be obtained through the relational capital. Alliances, partnerships and other forms of inter-firm relationships have been prescribed as effective choices for gaining, leveraging, or developing new competencies and resources (Silvi and Cuganesan, 2006). What the literature appears to be suggesting is that competitive advantage increasingly is achieved by those firms that succeed in mobilizing their intangible assets in the form of knowledge, technological skills, experience, and strategic capabilities toward creating new processes and product or service offerings (Tovstiga and Tulugurova, 2007: 697). Examining the definition of relational capital, it appears as; the flow of knowledge within and to the outside of the organization through the relational networks constituted in, and around the organization. Competitive advantage is achieved by mobilization of intangible assets, the mobilization of intangible assets inside and outside of the organization is achieved through relational capital. Hence the relational capital will be able to create competitive advantage for the firm through the establishment of a distinctive core competency in the form of relationships embedded into organization controlled networks (Subramaniam and Youndt, 2005).

**Hypothesis 3a:** Relational capital positively affects the creation and maintenance of effective interactions and good relationships.
**Hypothesis 3 b:** The creation and maintenance of effective interactions and good relationships positively affects competitive advantage.
**Hypothesis 3 c:** Relational capital positively affects competitive advantage.

Formulation of strategy in order to reach to the objectives determined by an organization will generate competitive advantage for the organization. The strategic management literature focuses on the concept of performance increase. The strategy formulation is the instrument in the achievement of high performance. The achievement of high performance provides the outcome of competitive advantage (Meyer et al., 2002). The strategy formulation can be thought as the modeling of a simulation for the analysis of inputs/datasets, limitations/constraints and outputs/results. The strategy constitutes a pathway in the achievement of the objectives. Marr et al. (2003) refer to the definition of Kenneth Andrews (1971) about the corporate strategy as "the pattern of decision making in a company that determines and reveals its objectives, purposes, or goals, produces the principal policies and plans for achieving those goals, it defines the range of business the company has to pursue, the kind of economic and human organization it is or intends to be, and the nature of the economic and non-economic contribution it intends to make to its shareholders, employees, customers, and communities." In addition to examining, the strategy identifies the competitive forces, opportunities, and threats of the industry, besides organizations have to identify their corporate competence and resources in order to evaluate opportunities. The question; "does the organization have the right competence to pursue certain opportunities?" has to shed light to the pathway of the organizations (Marr, Gray and Neely, 2003). Kenneth Andrews brings the strategic importance of competences to ahead when he states that "opportunism without competence is a path to fairyland" mention, Marr et al. (2003). This is examining the intellectual capital possession of the organization itself and knowing how to utilize and integrate it into business strategy. An important objective of this phase is to identify the intellectual capital between business strategy and the capabilities of the existing intellectual capital structure(Tan, Plowman and Hancock, 2008). Rylander and Peppard (2003) propose a concept which links competitive strategy, identity and intelectual capital for knowledge intensive companies competeing in uncertain environments. The proposed concept supports the idea that the strategy and intellectual capital as a resource are linked and need to be mobilised to succeed the strategy. Many of the most critical resources in a knowledge-intensive firm are intellectual capital resources like structures, processes, systems, culture, brands, competencies and relationships with customers. The financial and physical resources support the intellectual capital resources and are an integral part of a firm's strategy(Tan Plowman and Hancock, 2008). Regarding all the above discussion, the tool in the determination of decision making pattern of a company, with the analysis of; strengths and weaknesses in facing opportunities and threats, is intellectual capital. Human capital determines the strengths and weaknesses (knowledge, skills, capabilities, experiences, performance, education, behavior, loyalty, commitment, satisfaction etc.) of the employees. Organizational capital provides for the codification of the knowledge, skills, capabilities, organizational culture, organizational learning capabilities all the intangible assets owned by the organization to the structure of the firm through technological systems, routines, patents, processes, software, hardware and organizational management. So that the competences creating value are hard to imitate, transfer or steal from the integrated structure of the organization. The relational capital explores internal and external opportunities and threats by the intra and inter-organizational relationship networks constituted. Hence the awareness of the threats and opportunities awaiting will lead the organization to take right steps regarding their strengths and weaknesses explored by intellectual capital's components in collaboration. Therefore, firms need to strategically identify and develop their intellectual capital in order to gain a competitive advantage and to increase their performance (Marr et al., 2006). The key to a resource-based approach to strategy formulation is to understand the relationships between intellectual capital, competitive advantage, and profitability (Marr, Gray and Neely, 2003).

**Hypothesis 4 a:** Intellectual capital positively affects the strategy formulation through the exploration of strengths, weaknesses, opportunities and threats.
**Hypothesis 4 b:** The strategy formulation positively affects the competitive advantage.
**Hypothesis 4 c:** Intellectual capital positively affects competitive advantage.

Given the increasing importance of innovation as a major competitive weapon for many organizations (Porter, 1990), after decades of research in a wide range of disciplines, including economics, marketing, and organization behavior, Huang and Chang (2008) identified Chandrashekaran et al.'s, (1999) argument, which have centered on a fundamental question: "what are the drivers of innovation" (Huang and Chang, 2008). The acceleration of R&D efforts and the development of internal innovative capabilities are no longer sufficient to cope with the increasing cost, speed, and complexity of technological developments. In recent decades, there has been unprecedented growth in corporate partnering and an increasing reliance on various forms of external collaboration (Huang and Chang, 2008). A growing body of literature, focusing on different industrial sectors and both large and small firms, regards collaborative practices as a viable method of knowledge creation and transfer (Huang and Chang, 2008). Thus, innovation generation has increasingly become recognized as an outcome of the relationship between a firm and outside entities (Huang and Chang, 2008). Learning is a related issue because rapid and proactive learning leads to knowledge expansion, and this in turn is the engine for corporate renewal. Learning provides the ability to adapt, innovate and compete. Learning is vital to an organization's sustained competitiveness. In fact the value of learning has risen steadily as a result of the speed of change: as situations constantly shift and alter, managers are foolish if they believe they have all the answers (Freeman, 2001). What matters now is not how much people know, but how they react to what they do not know (Freeman, 2001). Recently, knowledge-sharing with suppliers has received increasing research attention (Huang and Chang, 2008). Manufacturers have discovered the managerial, technological, and financial benefits that may accrue as a result of close ties with suppliers. Scholars also generally agree that a substantial part of the innovation process occurs between buyers and sellers in the supply chain. Accordingly, a large body of strategy-level research on buyer-seller interaction and innovation outcomes has emerged. Huang and Chang (2008) argue that an embedded tie between a manufacturer and the primary supplier provides a foundation of trust, joint problem-solving and commitment mechanisms. These mechanisms enable joint action between partners to facilitate incremental innovation (Huang and Chang, 2008). Further, we know that through the combinations we can devise competitive positions or distinctive core competencies that yield us rents. These rents can be long lasting if the resource in question is rare, inimitable, and non-substitutable (Hoffmann et al., 2006: 140). However, the question remains: How do we attach the quality of longevity to our superior resource? What a firm wants is to create a situation where its own resource position directly or indirectly makes it more difficult for others to catch up. One possible way to create such a resource is the capability of innovating. Innovation is not imitable, once imitated it turns out to be not new anymore, it is rare because not every organization can result its research with a radical or incremental innovation and it's non-substitutable because it is unique and obtained as a result of efforts that are hard to compensate (Hoffmann et al., 2006: 140).

**Hypothesis 5 a:** Relational capital positively influences innovation.
**Hypothesis 5 b:** Relational capital positively influences competitive advantage.
**Hypothesis 5 c:** Innovation positively influences competitive advantage.

## The Proposed Model

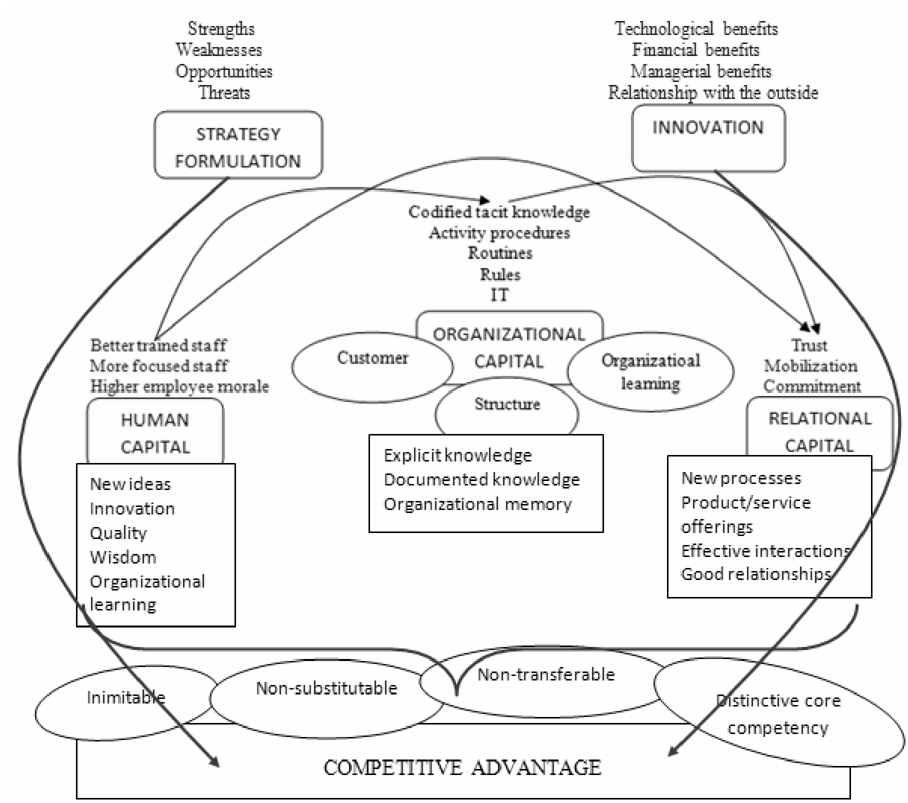



**Figure 5. The proposed model, representing the relationship between competitive advantage and intellectual capital.**

# METHODOLOGY

This study aiming to obtain the conceptual framework underlining, the relationship between the intellectual capital and the competitive advantage, is based on an extensive literature review. The methodology consisted of developing a conceptual framework, where 5 hypotheses are presented regarding the relationship between intellectual capital and competitive advantage. The first hypothesis focused on the human capital's relationship with competitive advantage and according to the extensive literature review; the statement resulted as human capital positively influences competitive advantage. The second hypothesis is based on the positive influence of organizational capital on competitive advantage. The third hypothesis states that the relational capital positively influences competitive advantage. The fourth hypothesis is about the positive influence of intellectual capital on strategy formulation and the positive influence of strategy formulation on competitive advantage. Therefore, the intellectual capital positively influences the competitive advantage hypothesis is obtained. And the last hypothesis is that innovation positively influences competitive advantage through the relational capital. A possibility of future research is the testing of the hypotheses with the application of survey method to the industrialists of selected sample pool. The next study regarding the statistical support to the present study will consist of a two-stage research design. The first stage will be based on the determination of compatible measures of intellectual capital and competitive advantage, by the examination of previous studies. The second stage will be consisting of questionnaires, aiming to gather data about the intellectual capital and competitive advantage measures of the organizations. The questionnaires will be sent to the selected sample pool of product managers, project managers and R&D engineers via e-mail. Using a five-point Likert-type scale the obtained results will be used to measure different aspects of intellectual capital having influence on the creation of competitive advantage in strategic management context.

# CONCLUSION

The main purpose of this study has been to explore the intellectual capital, rather than the traditional tangible assets –land, facility, work force, physical and financial capital- considered as capital, in depth as a crucial factor creating the competitive advantage for the organizations in turbulent markets, shifting towards dynamic nature and mainly from production based to the knowledge based economy. In addition to examining the intellectual capital, the relationship between firm intellectual capital and competitive advantage is focused on. This study develops a platform through which intellectual capital shapes the strategic management of the organizations for the aim of achieving the competitive advantage. Previous studies rarely examined the connection and relevancy of intellectual capital, and the competitive advantage. Noticing the transformation of firms' main goals from the profit maximization to value maximization, the intellectual capital that assures the creation and management of knowledge became the most important asset of the knowledge based economy, since the knowledge is the creator of value and effective management of knowledge is the fundamental instrument in maximizing value. This study contributes to the literature by proposing a theoretical model considering the relationship of intellectual capital with the generation of competitive advantage in knowledge intensive organizations.

IC can be interpreted as the basis for a distinctive competency since it can be the basis of significant organizational change (Kong and Prior, 2008). In October 2000, the European high-level expert group on the intangible economy presented new evidence on the influence of business intangibles on economic performance and productivity (Eustace, 2003). There is, however, an overwhelming weight of evidence to support the view that the advanced economies have undergone a significant but largely undetected shift in the mode of wealth creation over the past few decades (Eustace, 2003). In the past, competitive advantage was attributed to the successful exploitation of scale economies underpinned by a unique technology or dominance of a geographical market or supply-chain. It is now widely accepted that winning strategies are more often grounded in the accumulation and creative exploitation of intangibles. The empirical evidence suggests that successful players in competitive markets are those that have access to a corpus of unique – or at least difficult-to-replicate – capabilities and competences (Eustace, 2003). Modern managers need to understand the changing environment, the emergence of the knowledge-based economy, what IC is and how to manage and harness it for greater competitiveness (Tan, Plowman and Hancock, 2008). Knowledge is a critical factor affecting an organization's ability to remain competitive in the new global marketplace (Bollinger and Smith, 2001).

However, for IC to command the attention of management it must give companies a competitive edge and result in superior financial performance. There must be practical applications for the study of IC. From a strategic perspective, IC can be used to create knowledge that enhances a firm value. In the study of Tan et al. (2008), Marti (2001) statement is presented:
"Researchers in the areas of sustainable competitive advantages have come to the conclusion that the only thing that gives an organization a competitive edge, the only thing that is sustainable, is what it knows, how it uses what it knows, and how fast it can know something new. The key role of knowledge as a source of competitive advantage is to produce intellectual capital in an efficient way" (Tan, Plowman and Hancock, 2008). Under increasing competitive pressure, many companies are examining how they can manage their intellectual capital more efficiently. Tan et al. (2008) refer to the argument of Civi (2000) that a company's knowledge management strategy should reflect its competitive strategy. This includes how it creates value for customers, how that value supports an economic model, and how the company's people deliver on that value. Also, competitive strategy must drive knowledge management strategy and executives must be able to

articulate how knowledge that resides in the company adds value for customers (Tan Plowman and Hancock, 2008).

In the arguments this study proposes it's clearly shown that intelectual capital positively influences competitive advantage through its elements, through the strategic management perspective of a strategy formulation and through the consept of innovation. To conclude with; the authors identified the assesment of Brennan and Connell (2000) in Guthrie and Petty's (2000) study indicating that intellectual capital management is found to be important for a company's long-term success. Companies managing their own intellectual capital outperformed other companies (Guthrie and Petty, 2000).

# REFERENCES

Anell, B.I. and Wilson, T.L. (2002), "Prescripts: creating competitive advantage in the knowledge economy", Competitiveness Review, Vol. 12 No. 1, pp. 26-37.

Carneiro, A. (2000), "How does knowledge management influence innovation and competitiveness?", Journal of Knowledge Management, Vol. 4 No. 2, pp. 87-99.

Civi, E. (2000), "Knowledge management as a competitive asset", Marketing Intelligence & Planning, Vol. 18 No. 4, pp. 166-74.

Chang, L. and Birkett, B. (2004), Managing intellectual capital in a professional service firm: Exploring the creativity–productivity paradox, Management Accounting Research**,** 15, pp. 7-31.

Chen, Y.-S., Lin, M.-J., Chang, C.-H. (2006), The Influence of Intellectual Capital on New Product Development Performance– The Manufacturing Companies of Taiwan as an Example, Total Quality Management, 17 (10), pp. 1323-1339.

Cuganesan, S. (2005), Intellectual Capital in Action and Value Creation, Journal of Intellectual Capital**,** 6 (3), pp. 357- 373.

Feland, J., M. (2005), Product Capital Model: Modeling the Value of Design to Corporate Performance, pp. 1-136.

Greeve, Henrich, R. (2009), Bigger and Safer: The Diffusion of Competitive Advantage, Strategic Management Journal, 30, pp. 1-23.

Hofman, J., Hoelscher, M. and Sorenson, R. (2006), Achieving Sustained Competitive Advantage: A Family Capital Theory, Family Business Review, 19 (2), pp. 135-145.

Isaac, R., Herremans, I. and Kleine, T. (2009), Intellectual Capital Management: Pathways to wealth Creation, 10 (1), pp. 81- 92.

Kaufmann, L. and Schneider, Y. (2004), Intangibles: A synthesis of current research, Journal of Intellectual Capital, 5 (3), pp. 366- 388.

Kong, E. (2008), The Development of Strategic Management in the Non-Profit Context: Intellectual Capital in Social Service Non- Profit Organizations, International Journal Management Reviews, 10 (3), pp. 281-299.

Martin-de-Castro, G., Navas-Lopez, J.E., Lopez-Saez, P. and Alama-Salazar, E. (2006), "Organizational capital as competitive advantage of the firm", Journal of Intellectual Capital, Vol. 7 No. 3, pp. 324-37.

McPhail, K. (2008), Where is the Ethical Knowledge in the Knowledge Economy? Power & Potential in the Emergence of Ethical Knowledge as a Component of Intellectual capital, Critical Perspectives in Accounting, 1-39.

Montequin, Vincent R., Fernandez, Francisco O., Cabal, Valeriano A. and Gutierrez, Nieves R. (2006) An Integrated Framework for Intellectual Capital Measurement and Knowledge Management Implementation in Small and Medium-Sized Enterprises, Journal of Information Science, 32 (6), pp. 525-538.

Nonaka, I. (1995), The Knowledge Creating Company, Harvard Business Review on Knowledge Management, Harvard Business School Press, Boston, MA, 1998, pp. 21-45.

Petty, P. and Guthrie, J. (2000), "Intellectual capital literature review: measurement, reporting and management", Journal of Intellectual Capital, Vol. 1 No. 2, pp. 155-75.

Schulze, A. and Hoegl, M., (2006), Knowledge Creation in New Product Development Projects, Journal of Management, 32 (2), pp. 210-236.

Seetharaman, A., Low, K. and Saravanan, A., S. (2004), Comparative Justification on Intellectual Capital, Journal of Intellectual Capital**,** 5 (4), pp. 522-539.

Subramaniam, M. and Youndt, M. (2005), The Influence of Intellectual Capital on the Types of Innovative Capabilities, Academy of Management Journal, 48 (3), pp. 450- 463.

Tovstiga, G. and Tulugurova, E. (2007), Intellectual Capital Practices and Performance in Russian Enterprises, Journal of Intelectual Capital, 8 ( 4), pp. 695- 707.

White, Larry N. (2007), Unseen Measures: The Need to Account for Intangibles, The Bottom Line, 20 (2), pp. 77-84.

Wu, Y.-W., Chang, M.-L. and Chen, C.-W. (2006), Promoting innovation through the accumulation of intellectual capital, social capital, and entrepreneurial orientation, R&D Management, 38 (3), pp. 265-277.

Y.-H. Hsu, and W. Fang, (2008), Intellectual capital and new product development performance: The mediating role of organizational learning capability, Technological forecasting & Social Change, pp. 1-14, doi:10.1016/j.techfore.2008.03.012.

# THE EFFECTS OF ORGANIZATIONAL POLITICS AND STRATEGIC POSTURE ON INNOVATION PERFORMANCE

**Sevki Ozgener**
**Nevsehir University**

**Adem Ogut**
**Selcuk University**

**Metin Kaplan and D. Mehmet Bickes**
**Nevsehir University**

## ABSTRACT

*Strategic posture is crucial to family-owned businesses for survival. In this study, we investigate the effects of organizational politics and strategic posture (as measured by the Miles-Snow strategic typology of prospectors, analyzers, defenders, and reactors) on innovation performance in family-owned businesses. The findings of the research indicated that prospectors were positively and significantly correlated with innovation performance. Similarly, innovation performance was found to be positively related to strategic posture of sector. The results showed that prospector was a significant predictor of innovation performance. According to the result of regression analysis, the interaction term of the perceptions of organizational politics and prospectors had a negative effect on innovation performance. However, the interaction of the perceptions of organizational politics and analyzers had a positive effect on innovation performance. Moreover, practical implications are discussed, and suggestions for the future research are made.*

***Key words:*** *Strategic Posture, Organizational Politics, Innovation Performance, and Family-Owned Business.*

## INTRODUCTION

Family-owned businesses have been the focus of numerous studies during the last few years due to their capacity to generate employment as well as their essential role in the wealth creation process (Garcia et al., 2007:152). Researchers have suggested the use of multiple conditions to distinguish family from non-family business. Frequently used conditions include family ownership and control, family influence in decision making, operational aspects of a business, family members as employees and the intent to transfer the family firm to the next generation (Kotey, 2005: 395; Matlay, 2002: 361).

Innovation performance is commonly considered as a key component in family-owned businesses competing successfully in the market. In fact, the necessity for innovation of family-owned businesses has increased because of some factors such as shorter product cycles, increased segment fragmentation, increased competition and changing requirements of customer (Ozsomer et. al., 1997: 401). However, there are some factors such as organizational structure, unqualified employees, lack of finance, poor organizational culture, organizational politics and strategic posture that affect family-owned businesses' innovation performance negatively. Particularly, the market environment in the manufacturing industry is likely to be more competitive in terms of product and product innovation than in other industries. Therefore, the goal of this study is to examine the effects of organizational politics and strategic posture on innovation performance for family-owned businesses in manufacturing industry.

## Organizational Politics

Organizational politics is an integral aspect of organizational life and relates to power, authority and influence. Over the years, scholars have tried to define organizational politics in various ways. Organizational politics is defined as “social influence attempts directed at those who can provide rewards that will help promote or protect the self-interest of the actor” (Haris et al., 2005: 29). Organizational politics can be viewed as intentional actions (either covert or overt) by individuals to promote and protect their self-interest, sometimes at the expense of and without regard for the well-being of others or their organizations (Byrne, 2005: 176).

Organizational politics is defined as ‘‘a social influence process in which behavior is strategically designed to maximize short-term or long-term self-interest, which is either consistent with or at the expense of others’ interests’’. Perceptions of organizational politics are fueled by conditions such as uncertainty about organizational decisions, ambiguity about expectations, procedures, or roles, and competition for scarce resources (Miller et al., 2008). Perceptions of politics usually reflect employees’ views about the level of power and influence used by other organizational members to gain advantages and secure their interests in conflicting situations. The higher the perception of politics, the lower the sense of fairness and equal treatment, because people with more power are in a better position to satisfy their interests and needs at the expense of others who have less political resources and influence (Vigoda-Gadot et al. 2003: 766).

Previous empirical studies supported a direct and negative relationship between perceptions of organizational politics and job performance (Chen and Fang, 2008; Edwards, 2007; Zivnuska et al., 2004). Similarly, we assume that organizational politics perceptions have a negative influence on innovative performance. But a little research has been done about organizational politics and innovation performance.

## Strategic Posture

Strategic posture has received much attention and investigation in management literature over the last two decades (Di Benedetto and Song, 2003: 514). Strategic posture refers to the way an organization’s decision makers respond to external demands. An active posture involves deliberate efforts to manage the impressions of important stakeholders. With a passive posture, no attempt is made to monitor stakeholder concerns, or to define an optimal stakeholder management strategy (Magness, 2006: 545). Undoubtedly, both active and passive postures have an effect on innovation performance of the businesses.

Strategic posture has an important impact on long-term performance. In connection with the strategic posture, in this study Miles and Snow’s (1978) generic strategy typology will be taken up as references. Miles and Snow’s classification of strategic behaviour into four types is well known (Elwood Williams and Tse, 1995: 23). They contend that the prospector, defender and analyzer styles are capable of leading to competitive advantage within the industry. However, they caution that the reactor style is often a manifestation of a poorly aligned strategy and structure and therefore unlikely to lead to competitive advantage (Zahra and Pearce, 1990). Miles and Snow’s typology of strategy is as follows (Elwood Williams and Tse, 1995: 23; O’Regan and Ghobadian, 2006: 606; Mavondo, 2000: 257; Parnell et al., 2000: 521):

*Prospectors.* Prospectors are characterized by a strong and consistent exploration of new markets, technological uses, product designs, and organizational operations. These tend to operate in volatile environments and are continually searching for market opportunities. In brief, prospector organizations are constantly seeking innovation in business. Most often, prospectors consider innovation as the organization’s key competitive advantage

*Analyzers*. They watch competitors closely, then adopt the most promising new ideas using their efficient research and production skills. Analyzers stress both stability and flexibility and attempt to capitalize on the best of both of the preceding strategic types.

*Defenders.* These organizations tend to operate in a narrow and stable product-market domain. Top managers are highly expert in their organization’s limited area of operation but do not tend to search outside the domain for new opportunities. Hence, defenders may be poorly placed to respond when customers’ needs change. Primary attention is devoted to improving efficiency of existing operations and to avoid unnecessary risk.

*Reactors*. Reactors lack consistency in strategic choice and perform poorly. Management perceives change and uncertainty but is unable to cope with it. Change inevitably presents some difficulties. This strategy is not viable in the long term.

Many authors have highlighted the important role of strategic posture. However, a little research investigated the relationship between strategic posture and innovation performance. Ozsomer et al. (1997) examined organizational and environmental factors affecting innovativeness. They found that a prospector strategic posture strongly influenced innovation. Similarly, Tanewski et al. (2003) analyzed the relationship between strategic orientation and innovation performance in terms of family and non-family firms. Results indicated that strategic posture had a significant effect on innovation performance for both family and non-family businesses. Moreover, Jogaratnam and Tse (2006) examined whether or not entrepreneurial strategic orientation is associated with organizational structure within the context of the Asian hotel industry. Results suggested that entrepreneurial strategic posture was positively associated with performance. O'Regan and Ghobadian (2006) investigated the perceptions of generic strategies of small and medium sized engineering and electronics manufacturers. According to the findings of this study, prospectors tended to perceive their environment as "dynamic" whereas defenders perceived their environment as "stable".

## Innovation Performance

Innovation performance reflects the firm's ability to be a first user of new ideas, devices, systems, policies, programs, processes, product and services (Zehir and Ozsahin, 2008: 714). Innovation performance includes the number of innovations, speed of innovation, level of innovativeness (novelty or newness of the technological aspect), and being the "first" in the market (Prajogo and Sohal, 2003: 906). In the global competitive environment, having the higher level of the innovation performance is the basic desire of the business management. However, the organizational politics and the strategic posture of many firms have a distinctive effect on the innovation performance in the manufacturing industry. Although a little research has been done about this study (Oke, 2007), Zehir and Ozsahin (2008) analyzed the relationships of organizational factors and environmental factors affecting strategic decision-making speed and innovation performance. The results suggested the strong relationships among participation, strategic decision speed and innovation performance were highlighted.

As we explained above, this study is needed because the researches relevant to the effects of organizational politics and strategic posture on innovation performance are limited. The research objective of this study is to investigate the effects of organizational politics and strategic posture (as measured by the Miles-Snow strategic typology of prospectors, analyzers, defenders, and reactors) on innovation performance in family-owned businesses. The following hypothesis will be tested in this respect:

**H1:** Perceptions of organizational politics will be negatively related to innovation performance.

**H2:** Prospectors will be positively related to innovation performance.

**H3:** Analyzers will be positively related to innovation performance.

**H4:** Defenders will be negatively related to innovation performance.

**H5:** Reactors will be negatively related to innovation performance.

**H6:** Perceptions of organizational politics will moderate the relationship between prospectors and innovation performance.

**H7:** Perceptions of organizational politics will moderate the relationship between analyzers and innovation performance.

**H8:** Perceptions of organizational politics and defenders have a negative impact on innovation performance.

**H9:** Perceptions of organizational politics and reactors have a negative impact on innovation performance.

# METHODOLOGY

## Sample and Procedure

The sampling consists of family-owned businesses in the manufacturing industry in the province of Konya, Turkey. The data for this survey are collected from managers of businesses in manufacturing industry listed in Konya Chamber of Industry. Interviewers were used to distribute questionnaires to the family-owned businesses.

In this study 200 family-owned businesses were randomly selected. A total of 68 questionnaires were returned, yielding a response rate of 34 percent. The demographic profiles of respondents are shown in Table 1. Of the 68 respondents, 92.6 percent were male and 7.4 percent were female. Almost 53 percent of the respondents were between 38 and 52 years old. 55.9% of those responding had more than 5 years of managerial experience. In terms of education levels, 20.6% of the respondents had graduated from primary school, 14.7% from secondary school and 29.4% from high school. 30.9 percent of the participants had a bachelor's degree and 4.4% had a master's degree or higher.

**Table 1: Demographic Characteristics of Sample**

| Characteristics | f | (%) | Characteristics | f | (%) |
|---|---|---|---|---|---|
| ***Size of business (number of employee)*** | | | ***Managerial experience (number of years)*** | | |
| 1 to 25 | 26 | 38.2 | 0-5 | 30 | 44.1 |
| 26 to 50 | 28 | 41.2 | 6-10 | 14 | 20.6 |
| 51 to 75 | 4 | 5.9 | 11-15 | 9 | 13.2 |
| 75 or more | 10 | 14.7 | More than 15 | 15 | 22.1 |
| **Industry Category** | | | **Gender** | | |
| Metal industry, metal tools, machinery and equipment. | 27 | 39.7 | Female | 5 | 7.4 |
| | | | Male | 63 | 92.6 |
| Chemicals, oil products, rubber and plastics | 15 | 22.1 | **Age** | | |
| Food, beverages and tobacco | 6 | 8.8 | Less than 30 | 4 | 5.9 |
| Automotive | 7 | 10.3 | 30-35 | 20 | 29.4 |
| Construction and Cement | 3 | 4.4 | 36-45 | 28 | 41.2 |
| Others (textile, paper products, electronics and computer etc.) | 10 | 14.7 | 45 or more | 16 | 23.5 |
| | | | **Education Level of Participants** | | |
| **Organizational title/rank** | | | Primary school | 14 | 20.6 |
| General manager (CEO, president, general director) | 6 | 8.8 | Secondary school | 10 | 14.7 |
| | | | High school | 20 | 29.4 |
| Owners | 37 | 54.4 | Bachelor' degree | 21 | 30.9 |
| Division Manager | 15 | 22.1 | Master's degree or PhD | 3 | 4.4 |
| Other | 10 | 14.7 | | | |
| **Status of a person** | | | | | |
| Married | 53 | 77.9 | | | |
| Single | 15 | 22.1 | | | |

N= 68

Respondents held a variety of positions in family-owned business. They included General Manager (8.8%), Owners (54.4%), Division Manager (22.1%) and others (14.7%). When industry category is taken into consideration, it is seen that the family-owned business that responded to the survey operate in metal and machinery industry (39.7 percent), chemicals and plastics industry (22.1 percent), food, beverages and tobacco industry (8,8 percent), construction and cement (4,4 percent) and other industries (14.7 percent). These firms operate in local markets (5.9%), national markets (48.5%) and international markets (45,6%). Furthermore, 22.1% of the family-owned businesses responding to the survey don't allocate resources for R&D. 17.9% of the businesses allocated more than five percent of resources for R&D, while almost 60% of these businesses allocated only five percent of resources for R&D.

## Measures

Innovation performance was designated as the dependent variable in this study, while strategic posture and perceptions of organizational politics were considered as the independent variables. Existing scales were adopted to measure all three constructs. To measure perceptions of politics, we used the 15-items Perceptions of Organizational Politics Scale (POPS) developed by Kacmar and Carlson (1997). Participants responded on a 5-point Likert-type scale dictating to the extent which they agreed with each statement as it reflected their present work environment (1= strongly disagree, 5= strongly agree). The internal reliability estimated for this sample was 0.76. On the other hand, to measure strategic posture, we used strategic typology multi-item scale developed by Miles and Snow (1978) and adopted by Conant et al. (1990). The strategic typology contains 44 items which are designed to produce 11 scales of 4 items each.

In this study, each item of 11 scales represents the characteristics of prospector, analyzer defender and reactors in Miles and Snow's strategy typology. Firstly, typologies of 68 family-owned businesses were determined severally. For example, if most of respondents mark item which closely reflects the features of prospectors to determine the strategic posture of a business, the strategic posture of this business is accepted as a prospector. But the numbers of prospector and analyzer can be equal. In this case, if respondents mostly choose the item which best reflects the features of "defender"; the business is assumed as a prospector. If respondents mostly mark the item which best reflects the features of "reactors", the business is accepted as an analyzer. A similar procedure was used to determine the strategic posture for analyzers, defenders and reactors. Secondly, so as to establish the strategic posture of sector, 1, 2, 3 and 4 scores varying related to typology embraced by business for 11 scales of 4 items each were determined. If most of respondents mark item which reflects the features of prospectors, the business is evaluated as prospector (4 score), analyzer (3 score), defender (2 score) and reactor (1 score). On the contrary, If most of respondents mark item which reflects the features of reactors, the business is evaluated as prospector (1 score), analyzer (2 score), defender (3 score) and reactor (4 score). After scores were indicated on a scale from 1 to 4, the strategic posture of sector was stated by estimating means of each scale. Finally, in order to be compatible with strategic consciousness, the final numerical value of the strategic posture of each typology was calculated by multiplying the means of the strategic posture of sector and the value of each typology (prospectors, analyzers, defenders and reactors).

In this study, innovation performance is measured with a three-item 5-point Likert scale (1=strongly disagree, 5=strongly agree) developed by Prajogo and Sohal (2006). The scale showed adequate reliability. The Cronbach's alpha coefficient was 0.92. In general, a value of 0.70 in the Cronbach's alpha is considered adequate in order to ensure reliability of the internal consistency of a scale (Nunnally, 1978).

## THE RESULTS

Table 2 reports means, standard deviations, correlations among variables, and cronbach's alpha coefficients. As predicted, prospectors were positively and significantly correlated with innovation performance at the 0.01 level. The result supported H2. Also, there was a positive but not significant correlation between analyzers and innovation performance. Thus, H3 was not supported.

Defenders and reactors were negatively related to innovation performance but not significant. Thereby, H4 and H5 were not supported. On the other hand, innovation performance was a positively significant relation between strategic posture of sector ($r=0.289$, $p<0.05$) and education ($r=0.258$, $p<0.01$). However, perceptions of organizational politics were found to be positively related to innovation performance, although the relationship was not statistically significant. Thus, the results was not supported H1. Furthermore, the correlation between perceptions of organizational politics and strategic posture of sector was negative but not statistically significant.

**Table 2: Descriptive Statistics and Inter-correlations among Study Variables**

| | Mean | Std. Deviation | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1.Size of business | 1,97 | 1,02 | 1 | | | | | | | | | | |
| 2. Research and development (R&D) expenditures | 2,38 | 1,15 | ,161 | 1 | | | | | | | | | |
| 3.Managerial experience | 2,13 | 1,20 | -,190 | ,187 | 1 | | | | | | | | |
| 4.Education | 5,96 | 3,66 | ,363(**) | ,414(**) | -,041 | 1 | | | | | | | |
| 5.Prospectors | 3,04 | 1,33 | ,284(*) | ,209 | ,026 | ,384(**) | 1 | | | | | | |
| 6.Analyzers | 7,22 | 2,26 | ,332(**) | ,139 | ,026 | ,267(*) | ,785(**) | 1 | | | | | |
| 7.Defenders | 7,22 | 2,61 | -,224 | -,255(*) | ,013 | -,406(**) | -,599(**) | -,508(**) | 1 | | | | |
| 8.Reactors | 5,80 | 3,47 | -,326(**) | -,162 | -,048 | -,319(**) | -,805(**) | -,739(**) | ,762(**) | 1 | | | |
| 9.Perceptions of Organizational Politics | 2,62 | 0,38 | ,033 | -,251(*) | -,165 | ,067 | -,088 | -,121 | -,088 | ,008 | (0.76) | | |
| 10.Strategic posture of sector | 2,42 | 0,42 | ,020 | -,039 | ,004 | -,042 | ,281(*) | ,325(**) | ,500(**) | ,221 | -,207 | 1 | |
| 11.Innovation performance | 3,79 | 0,89 | ,238 | -,143 | -,108 | ,258(*) | ,311(**) | ,112 | -,004 | -,079 | ,018 | ,289(*) | (0.92) |

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).
Note: Correlations are relatively high among prospectors, analyzers, defenders and reactors since the means of the strategic posture of sector were used to calculate the numerical value of the strategic posture of each typology.

Hierarchical regression was used to test the hypotheses. Initially, the block of control variables were introduced into the model, followed by the appropriate independent and moderating variables. VIF values less than ten are often taken to indicate minimal collinearity. The VIF did not exceed 5.1 in all cases and it was therefore concluded that multi-collinearity was not a serious problem for the regression analyses that follow.

Table 3 presents the results of the hierarchical regression analysis. As it can be observed, the regression coefficients representing the main effect of prospectors on innovation performance is positive and significantly. As expected, the results showed that prospector was a significant predictor of innovation performance (β= 0.200; p <0.01). But Research and Development (R&D) expenditures had a negative and significant effect on innovation performance (β= -0.259; p <0.01).

The results show that Model 3 is significant ($R^2$=0.468; $F_{(13-54)}$ = 3.648; p <0.05). The interaction terms explained additional 11.3 percent of the variance in innovation performance. For innovation performance, Model 3 shows that the regression coefficient associated with the interaction term of the perceptions of organizational politics and prospectors is negative and statistically significant (β= -0.253; p <0.05). This result did not support H6. That is, the interaction term had a negative and statistically significant effect on innovation performance. However, the coefficient for the interaction between the perceptions of organizational politics and analyzers is positive and significant (β= 0.360; p <0.05) for innovation performance. Thus, H7 was not supported by the results.

**Table 3: The Results of Hierarchical Regression Analyses: The Effects of Organizational Politics and Strategic Posture on Innovation Performance**

| Independent variables entered | β | S.E. | t-value | $R^2$ | $R^2$ Change |
|---|---|---|---|---|---|
| *Model 1 F(4-63)= 3,161* | | | | 0.167 | |
| Size of business | ,148 | ,110 | 1,340 | | |
| Managerial experience | -,004 | ,089 | -,049 | | |
| Research and development (R&D) expenditures | -,234* | ,100 | -2,331* | | |
| Education | ,216* | ,090 | 2,400* | | |
| *Model 2 F(9-58)= 3,540* | | | | 0.355 | 0.187 |
| Size of business | ,188 | ,107 | 1,745 | | |
| Managerial experience | ,001 | ,083 | ,012 | | |
| Research and development (R&D) expenditures | -,259** | ,098 | -2,648** | | |
| Education | ,169 | ,090 | 1,880 | | |
| Perceptions of Organizational Politics | -,097 | ,241 | -,405 | | |
| Prospectors | ,200** | ,051 | 3,893** | | |
| Analyzers | -,118 | ,072 | -1,625 | | |
| Defenders | ,039 | ,061 | ,643 | | |
| Reactors | ,095 | ,062 | 1,542 | | |
| *Model 3 F(13-54)= 3,648* | | | | 0.468 | 0.113 |
| Size of business | ,216* | ,102 | 2,119* | | |
| Managerial experience | ,011 | ,082 | ,134 | | |
| Research and development (R&D) expenditures | -,309** | ,094 | -3,293** | | |
| Education | ,135 | ,087 | 1,561 | | |
| Perceptions of Organizational Politics | -,257 | 1,81 | -,142 | | |
| Prospectors | ,814* | ,266 | 3,065* | | |
| Analyzers | -,984* | ,409 | -2,405* | | |
| Defenders | ,080 | ,351 | ,228 | | |
| Reactors | ,450 | ,321 | 1,403 | | |
| Perceptions of Organizational Politics* Prospectors | -,253* | ,109 | -2,319* | | |
| Perceptions of Organizational Politics* Analyzers | ,360* | ,167 | 2,154* | | |
| Perceptions of Organizational Politics* Defenders | -,028 | ,144 | -,197 | | |
| Perceptions of Organizational Politics* Reactors | -,140 | ,129 | -1,082 | | |
| **Notes:** β indicates unstandardized regression coefficient. *p< 0.05; **p< 0.01 | | | | | |
| **Dependent variables:** Innovation performance | | | | | |

Moreover, the interaction between Perceptions of Organizational Politics (POPs) and defenders is negatively and not significant for innovation performance ($\beta$= -0.028; p> 0.05). Similarly, the coefficient for the interaction between POPs and reactors is negative and not significant ($\beta$=-.77, p< .01). As it can be observed, H8 and H9 were not supported by the results reported in Table 3.

# CONCLUSION

The topics of perceptions of organizational politics and strategic posture have received increasing attention from the field of organizational behaviour and strategic management. This study has investigated the effects of organizational politics and strategic posture on innovation performance in family-owned businesses in the province of Konya-Turkey. As predicted, prospectors were found to be positively and significantly correlated with innovation performance. The result is consistent with previous studies that have shown that there is strong positive correlate between strategic posture and innovation performance. Particularly, Ozsomer et al. (1997) showed that a prospector strongly influenced innovation. Similarly, Tanewski et al. (2003) indicated that strategic posture had a significant effect on innovation performance for both family and non-family businesses. Moreover, Jogaratnam and Tse (2006) suggested that entrepreneurial strategic posture was positively associated with performance.

Similarly, innovation performance was found to be positively significant relation between strategic posture of sector and education. On the other hand, defenders and reactors were negatively related to innovation performance but not significant. However, perceptions of organizational politics were found to be positively related to innovation performance, although the relationship was not statistically significant. Furthermore, the correlation between perceptions of organizational politics and strategic posture of sector was negative but not statistically significant.

The results of regression analyses showed that prospector was a significant predictor of innovation performance. The interaction term of the perceptions of organizational politics and prospectors had a negative and statistically significant effect on innovation performance. However, the interaction of the perceptions of organizational politics and analyzers is positive and significant for innovation performance. On the other hand, both the interaction of POPs and defenders, and the interaction of POPs and reactors were negatively and not significant for innovation performance. These results were supported by previous theoretical arguments and empirical evidence favouring the negative effect of perceptions of organizational politics on performance (Chen and Fang, 2008; Edwards, 2007; Zivnuska et al., 2004).

These results should be viewed in light of some possible limitations of this study. Firstly, we developed new procedure to calculate the numerical values of the typologies of strategic posture. The reliability of the procedure utilized in this study hasn't been proven yet in many different settings/countries. The second limitation is that this study has been conducted in family-owned businesses in a single-city setting (Konya). As a result, the generalizability of the findings might be limited. Consequently, additional researches across different industries and countries will be required in order to generalize the findings.

This research aimed to investigate the effects of organizational politics and strategic posture on innovation performance in family-owned businesses. For the upcoming research, it is available to investigate the strategic posture among different industries. Moreover, it would also to be interesting to establish the relationships between strategic intent and strategic posture for different industries or organizations.

# REFERENCES

Byrne, Z. S. (2005), Fairness reduces the negative effects of organizational politics on turnover intentions, citizenship behavior and job performance, *Journal of Business and Psychology*, 20 (2): 175-200.

Chen, Y., and Fang, W. (2008), The moderating effect of impression management on the organizational politics–performance relationship, *Journal of Business Ethics*, 79: 263–277.

Conant, J. S., Mokwa, M. P. and Varadarajan, P. R. (1990), Strategic types, distinctive marketing competencies and organizational performance: A Multiple-measures-based study, *Strategic Management Journal*, 11: 365-383.

Di Benedetto, C. A., and Song, M. (2003), The relationship between strategic type and firm capabilities in Chinese firms, *International Marketing Review*, 20 (5): 514-533.

Edwards, T. (2007), Organizational politics and the "process of knowing": understanding crisis events during project-based innovation projects, *European Journal of Innovation Management,* 10 (3): 391-406.

Elwood Williams, C., and Tse, E. C. Y. (1995), The relationship between strategy and entrepreneurship: The US Restaurant Sector, *International Journal of Contemporary Hospitality Management*, 7 (1): 22-26.

Garcia, D., Lema, P. and Durendez, A. ( 2007), Managerial behaviour of small and medium-sized family businesses: an empirical study, *International Journal of Entrepreneurial Behaviour & Research,* 13 (3): 151-172

Harris, K. J., James, M., and Boonthanom, R. (2005), Perceptions of organizational politics and cooperation as moderators of the relationship between job strains and intent to turnover, *Journal of Managerial Issues*, XVII (1): 26-42.

Jogaratnam, G. , and Tse, E. C. (2006), Entrepreneurial orientation and the structuring of organizations: Performance evidence from the Asian hotel industry, *International Journal of Contemporary Hospitality Management*, 18 (6): 454-468.

Kacmar, K. M., and Carlson, S. D. (1997), Further validation of the perceptions of politics scale (pops): a multiple sample investigation, *Journal of Management*, 23(5): 627-658.

Kotey, B. (2005), Are performance differences between family and non-family SMEs uniform across all firm sizes?, *International Journal of Entrepreneurial Behaviour & Research,* 11 (6): 394-421

Magness, V. (2006), Strategic posture, financial performance and environmental disclosure: An empirical test of legitimacy theory, *Accounting, Auditing & Accountability Journal,* 19 (4): 540-563.

Matlay, H. (2002), Training and HRD strategies in family and non-family owned small businesses: A comparative approach, *Education+Training,* 44 (8/9): 357-369.

Mavondo, F. T. (2000), Marketing as a form of adaptation: Empirical evidence from a developing economy, *Marketing Intelligence &Planning*, 18(5): 256-272.

Miles, R. and Snow, C. (1978), Organizational strategy, structure, and process, New York, McGraw-Hill.

Miller, B. K., Rutherford, M. A., and Kolodinsky, R. W. (2008), Perceptions of organizational politics: A meta-analysis, of outcomes, *Journal of Business Psychology,* 22: 209–222.

Nunnaly, J. C. (1978), Psychometric theory, 2nd edn. New York, McGraw-Hill.

O'Regan, N., and Ghobadian, A. (2006), Perceptions of generic strategies of small and medium sized engineering and electronics manufacturers in the UK: The applicability of the Miles and Snow Typology, *Journal of Manufacturing Technology Management*, 17 (5): 603-620.

Oke, A. (2007), Innovation types and innovation management practices in service companies, *International Journal of Operations & Production Management*, 27 (6): 564-587.

Ozsomer, A.., Calantone, R. J., and Di Benedetto, A. (1997), What makes firms more innovative? A look at organizational and environmental factors, *Journal of Business & Industrial Marketing*, 12 (6): 400-416.

Parnell, J. A., Lester, D. L., and Menefee, M. L. (2000), Strategy as a response to organizational uncertainty: An alternative perspective on the strategy-performance relationship, *Management Decision*, 38(8): 520-530.

Prajogo, D. I., and Sohal, A. S. (2003), The relationship between TQM practices, quality performance, and innovation performance: An empirical examination, *International Journal of Quality & Reliability Management*, 20 (8): 901-918.

Prajogo, D.I. and Sohal, A.S. (2006), The integration of TQM and technology/R&D management in determining quality and innovation performance, *International Journal of Management Science*, 34: 296-312.

Tanewski, G. A., Prajogo, D., and Sohal, A. (2003), Strategic orientation and innovation performance between family and non-family firms, *Proceedings of the 48th World Conference of the International Council of Small Business*, 15-18 June, Belfast: 1-22.

Vigoda-Gadot, E., Vinarski-Peretz, H., and Ben-Zion, E. (2003), Politics and image in the organizational landscape: An empirical examination among public sector employees, *Journal of Managerial Psychology,* 18 (8): 764-787.

Zahra, S. A., and Pearce, J. A. (1990), Research evidence on the Miles-Snow Typology, *Journal of Management,* 16 (4): 751-768.

Zehir, C., and Ozsahin, M. (2008), A field research on the relationship between strategic decision-making speed and innovation performance in the case of Turkish large-scale firms, *Management Decision*, 46 (5): 709-724.

Zivnuska, S., Kacmar, K. M., Witt, L.A., Carlson, D.S., and Bratton, V. K. (2004), Interactive effects of impression management and organizational politics on job performance, *Journal of Organizational Behavior*, 25: 627-640.

# THE EFFECTS OF ORGANIZATIONAL FACTORS ON R&D CAPABILITY

**Ali E. AKGÜN, Halit KESKİN, Ayşe GÜNSEL, Evren ÖZTÜRK**
**Gebze Institute of Technology, Turkey**

## ABSTRACT

*In this study it is aimed to investigate the effects of internal organizational factors as organizational structure, organizational learning, strategic planning, and resource allocation on R&D capability. After a deep literature review, a survey is conducted on high tech firms to test the hypothesis. 100 high tech firms participated the survey. Findings demonstrate that the organizational learning and organizational structure both have significant effects on R&D. However the results do not provide any evidence in support of the relationship between strategic planning resource allocation and R&D capability. Moreover the analyze results indicate that the impact of organizational learning on R&D capability is higher than the organizational structure.*

***Keywords:*** *R&D, organizational learning, organizational structure, resource allocation, strategic planning*

## INTRODUCTION

Since the 1980s, globalized competition has made its presence felt in many industries. The deregulation and globalization of financial markets has appeared with the introduction of new technologies (Reddy, 1997). The rise of global competition, and the emergence of new concepts such as continuous improvement, capability-based outsourcing and heavyweight project management have resulted with an increased attention on r&d and innovation activities from both business managers and academic communities (Söderquist and Godener, 2004). Innovation is considered to be an important aspect of competitive global firms and research and development (R&D) capability is an important source of such innovative activities (Johnson and Medcof, 2007)

R&D's complexity with the increasing importance of effective and efficient innovation activities for company success, and the growing pressure on R&D capability in respect of its actual contribution to company success have all given rise to a need to implement performance measurement of R&D capability (Perez-freije and Enkel, 2007). Studies for enhancing research and innovation capabilities have come to occupy a more important position for both academicians and practitioners (Wu, 2007). Existing literature on technology and innovation management (TIM), foreground many organizational internal factors that can be expected to contribute to the build-up of R&D capability such as organizational structure, organizational learning, strategic planning and resource allocation (Romijn and Albaladejo, 2002). Accordingly in this paper, we aim to investigate the relationships between internal factors as organizational structure, organizational learning, strategic planning, resource allocation and R&D capability.

## BACKGROUND

### The Concept of R&D Capability

In today's harsh and globalized competition in which the organizations pursue new techniques and solutions to improve their competitiveness (Scott-Ladd and Chan, 2004); the ability to quickly develop and introduce new products and services –R&D capability- has become an important part of the rivalry game (Yam et al., 2004). R&D capability is a unique asset of a firm. It is tacit and non-imitate, and it is correlated closely with interior experiences and experimental acquirement (Guan and Ma, 2003). A strong R&D capability is considered to be an important antecedent of achieving innovativeness and ultimately success (Yam et al., 2004; Perez-freije and Enkel, 2007). Fu (2008) states that such a capability is a key component of competitiveness at national, regional or firm levels.

Prior research shows that a firm's R&D capability is shaped by many internal and external factors (Cassiman, 2009). However there is still a gap in the literature concerning the factors affecting R&D capability. In this study we focused on the internal factors such as organizational structure, organizational learning, strategic planning and resource allocation

**Organizational Structure**

Organizational structure is one of the basic internal factors affecting the social interaction among organizational members (Chen and Huang, 2007). With the intention of optimally exploiting of human capital and other resources available to the firm, the firm has to have a suitable organizational structure. Moreover, the existing literature demonstrates that continuous adapting of the organizational structure is one of the basic functions of innovation management (Radas and Bosic, 2009). For example in contingency theory, organizational structures are considered as adaptations appropriate to technological and environmental conditions (Rank, 2008).

Organizational structure can be an important factor in determining R&D activities occur in a firm (Johnson and Medcof, 2007). For instance an organizational structure dominated by explicit rules and procedures is likely to impede the spontaneity and flexibility needed for internal R&D activities and innovation. Such organization refers to have a formal structure. Formalization refers to the degree to which employee behavior is guided by rules and procedures within the boundaries of the organization (Chen and Huang, 2007). We think that a formal organizational culture impedes the R&D capability while an informal one constitutes it by providing the flexibility, courage and risk taking to the organization and employees. Accordingly our first hypothesis is offered.

H1: Informal organizational structure will be positively related to R&D capability

**Organizational Learning**

Early studies on learning argue that learning takes place at the individual level, and individuals learn as driving forces for the organization. Even supposing that learning must be undertaken by individuals, it also depends on a variety of conditions in which the individuals are embedded. Learning take places also at the group, organizational, industrial, and even social levels (Jiang and Li, 2008). In other words firms learn from their own or others' experiences, success and failures, draw implications from them, and store their accumulated knowledge for future use. This organizational level process is called organizational learning (Yang et al., 2008).

On organizational learning process, by bringing the individual level knowledge to the organizational level; firms create new knowledge; the employment of this knowledge in processes and routines provides an essential building block of new competencies for innovative practices (Yang et al., 2008). There are many studies on organizational learning associated with organizational culture, strategy, structure, and environmental factors. However, there has not been much work attempting to specifically link R&D and innovativeness with organizational learning phenomena (Waldman et al., 2009). Accordingly our second hypothesis is offered:

H2: Organizational learning will be positively related to R&D capability

**Resource Allocation**

R&D is a complicated organizational function which necessities financial and human resources and infrastructure investments at a timely manner. In their study, Yam et al. (2004) underline the importance of resource allocation for R&D and innovation activities. Moreover by investigating 213 R&D projects within 21 firms, Markham et al. (1991) provide empirical evidence in support of the relationship between resource allocations and R&D project success. Accordingly our third hypothesis is offered:

H3: Resource allocation will be positively related to R&D capability

**Strategic Planning**

As the rapid technological changes have made innovation/R&D activities a key source of competitive strength; firms are adopting a variety of strategies to attain this innovative edge and thus maintain their competitiveness. (Reddy, 1997; Guan and Ma, 2003). For example Wang et al. (2008) suggests that for many high-tech products without an appropriate strategic planning concerning innovative activities, firms can have disastrous strategy results. Thus strategic planning becomes an important part of innovation and R&D activities (Yam et al., 2004). Accordingly our fourth hypothesis is offered:

H4: Strategic planning will be positively related to R&D capability

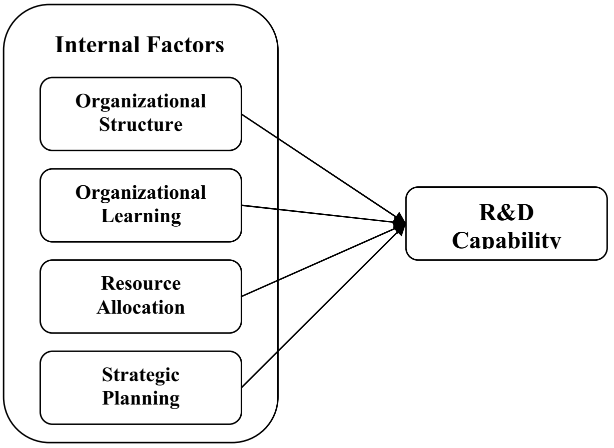



**Figure 1**. The theoretical model

# METHODOLOGY

## Data and Measures

The aim of this study is to evaluate the effects of organizational structure, organizational learning, resource allocation and strategic planning on R&D capability. In order to empirically investigate the hypothesis, high tech firms located around İstanbul and Gebze were surveyed. Using the documents obtained from KOSGEB, MAM and TEKMER, 150 firms among 300 are identified as the target group of the research because of their availableness. As a total of 100 questionnaires has returned. All constructs were measured with existing scales. All items were measured on a five point Likert-type scale where 1=strongly disagree and 5=strongly agree. Data is evaluated through SPSS 13.0. The relationships between the variables are tested using correlation, reliability, regression and factor analyses. The mean age of the participants were 32.17 (s.d.=5.58); the proportion of women, 13,8%, and married 49,5%. Of the participants, %87 had university educations and %28 had master education.

**Informal Organizational Structure**: Organizational structure was measured using five questions adapted from Jaworsky and Kohli (1993).
**Organizational Learning**: Organizational learning was measured using eight items from Yam et al.`s (2004) organizational learning scale.
**Resource Allocation:** Resource allocation was measured using eight items from Yam et al.`s (2004) resource allocation scale
**Strategic Planning:** Strategic planning was measured using six questions adapted from Yam et al. (2004).
**R&D Capability:** R&D capability was measured using eleven items from Yam et al.`s (2004) R&D capability scale.

## ANALYSIS

Since the scales were used with a new sample, 27 items of independent variables and 11 items of dependent variables were submitted to exploratory analysis. A principal component analyses and scree plot indicated that five factors should be retained (eigenvalues above1.0). The best fit of data was obtained with a principal factor analysis with varimax rotation.

**Table 1. Factor Analyses**

| | | | | |
|---|---|---|---|---|
| **Informal Organizational Structure** | Factor1 | Factor2 | Factor3 | Factor4 |
| I feel that I am my own boss in most matters | ,825 | | | |
| A person can make his own decisions without checking with anybody else | ,881 | | | |
| How things are done here is left up to the person doing the work | ,853 | | | |
| People here feel as though they are constantly being watched to see that they obey all the rules. | ,872 | | | |
| People here allowed to do almost as they please | ,835 | | | |
| **Organizational Learning** | | | | |
| Systematically monitoring technology development trends. | | ,838 | | |
| Capacity to assess technologies relevant to firm's business strategy. | | ,752 | | |
| Work teams encouraged to identify opportunities for improvement. | | ,636 | | |
| Assimilating acquired knowledge. | | ,763 | | |
| Understanding firm's core competencies and matching technological capabilities to market needs. | | ,758 | | |
| Learning the lessons of experiences. | | ,708 | | |
| Passing lessons learned across boundaries and time. | | ,749 | | |
| Cultivating learning readiness and investing on learning. | | ,648 | | |
| **Resource Allocation** | | | | |
| Programming human resource in phases. | | | ,683 | |
| Selecting key personnel in each functional department. | | | ,539 | |
| Steady capital supplement in innovation activity. | | | ,781 | |
| Flexibility and diversity of capital origins. | | | ,813 | |
| Cooperative innovation to reduce innovation cost. | | | ,691 | |
| Making fully use of external technologies. | | | ,793 | |
| Understanding competitors core technology competence. | | | ,819 | |
| Adapting self-technology level according to changes in the external environment | | | ,805 | |
| **Strategic Planning** | | | | |
| The extent of contingency thinking and planning. | | | | ,761 |
| Ability to identify internal strengths and weaknesses. | | | | ,879 |
| Ability to identify external opportunities and threats. | | | | ,776 |
| Goal clarity. | | | | ,769 |
| Availability of a clear plan—a road map with measurable milestones. | | | | ,765 |
| Adaptability and responsiveness of the company to external environment.. | | | | ,725 |

**Table 2. Factor Analyses**

| | |
|---|---|
| **R&D Capability** | Factor5 |
| Relevance of R&D plan to the corporate plan. | ,686 |
| Range of functions (departments) involved in concept development and screening. | ,736 |
| Clear project targets, project phase standards and project managing regulations. | ,817 |
| Presence of Cross-functional teamwork. | ,737 |
| Quality and availability of product champions. | ,807 |
| Efficiency of R&D personnel communication. | ,657 |
| Application of advanced designing methods, such as reengineering. | ,778 |
| Quality and speed of feedback from manufacturing to design and engineering. | ,778 |
| Mechanisms for transferring technology from research to development. | ,784 |
| Presence of established protocols such as design for manufacture, design for customer use. | ,829 |
| Extent of market and customer feedback into the innovation process. | ,770 |

The results of factor analyses show that the independent variables are gathered in four factors and the dependent variables are gathered into one. Factor 1 consists of five organizational structure items with an internal consistency reliability coefficient (Alpha) of 0, 9061. Factor 2 includes eight organizational learning items with an internal consistency reliability coesfficient of 0, 8761. Factor 3 includes eight resource allocation items with an internal consistency reliability coefficient (Alpha) of 0, 8847. Factor 4 includes six strategic planning items with an internal consistency reliability coefficient (Alpha) of 0,8704. Factor 5 includes eleven R&D capability items with an internal consistency reliability coefficient (Alpha) of 0, 9275. Table 1 shows the factor loadings of organizational structure, organizational learning, resource allocation and strategic planning while table 2 indicates the factor loadings of R&D capability.

**Table 3. Mean value and standard deviation**

| | **Mean Value** | **Standard Deviation** | **1.** | **2.** | **3.** | **4.** | **5.** |
|---|---|---|---|---|---|---|---|
| **1. Organizational Structure** | 2,7460 | 1,04711 | (0,906) | | | | |
| **2. Organizational Learning** | 3,3550 | ,81198 | ,320(**) | (0,876) | | | |
| **3. Resource Allocation** | 3,4638 | ,83263 | ,436(**) | ,679(**) | (0,885) | | |
| **4. Strategic Planning** | 3,2800 | ,83279 | ,525(**) | ,667(**) | ,770(**) | (0,87) | |
| **5. R&D Capability** | 3,3627 | ,82306 | ,441(**) | ,824(**) | ,680(**) | ,662(**) | (0,927) |

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05level (2-tailed).

Means, standard deviations and inter-correlations are summarized in Table 3. Cronbach`s Alpha values are shown using parentheses on the cross of the table. On a bivariate all the variables are found to be correlated to each other. This provides empirical evidence in support of the mutual relationships between organizational structure, organizational learning, resource allocation, strategic planning and R&D capability.

## Regression

Table 4. Regression results for cross organizational structure, organizational learning, resource allocation, strategic planning and R&D capability.

| **Independent variables** | **β** | **Sig** |
|---|---|---|
| Organizational Structure | 0,151* | 0,019 |
| Organizational Learning | 0,656** | 0,000 |
| Resource Allocation | 0,142 | 0,119 |
| Strategic Planning | 0,035 | 0,709 |
| **Dependent variable:** R&D Capability, $R^2$= 0,716 , F= 63,274 | | |

**: p< 0, 01, *: p< 0,05 (2-tailed)

In the regression analyze we investigated the influences of cross organizational structure, organizational learning, resource allocation and strategic planning on R&D capability. The regression model is significant as a whole (F=63,274: p< 0, 01) ; it explains %71,61 of the change of project speed. The findings shows that as we predicted in H1 informal organizational structure (providing the flexibility, courage and risk taking to the organization and employees) and as we predicted in H2 organizational learning (creating new knowledge by bringing the individual level knowledge to the organizational level) both have positive and significant effects on R&D capability. However the results do not provide any empirical evidence in support of the relationship between resource allocation (the distribution of financial and human resources and infrastructure investments at a timely manner), strategic planning (organizational process of defining strategy, or direction, and making decisions on allocating its resources to pursue this strategy, including its capital and people) and R&D capability. So our hypothesis H1 and H2 are supported while H3 and H4 are not.

# CONCLUSION

Researchers and practitioners have shown deep interests in the increasingly important role of innovation /R&D activities on firms' survival and competitiveness, but there is still a gap in the existing literature concerning the antecedents of R&D capability. As R&D literature still relies heavily on case studies, anecdotes, and consultants' frameworks, with little concrete findings; enhancing the literature with empirical studies is imperative for both scholars and practitioners.

In this study, the relationships between cross organizational structure, organizational learning, resource allocation, strategic planning and R&D capability on a developing country, Turkey. The findings of the study demonstrated that scales which are developed in Western countries, are appropriate for an emerging economy and eastern country; Turkey. Measures demonstrated high validity and reliability, and model results were similar with the empirical studies completed in developed and western countries.

The findings show that an organic organizational structure providing the flexibility, courage and risk taking to the organization and employees and creating new knowledge by bringing the individual level knowledge to the organizational level both play an important role on R&D capability. This means that in order to create and develop R&D capability, top management should build an informal structure which consists of autonomy, flexibility, vertical and horizontal two-way communication with little hierarchy and support learning at organizational level.

Moreover the results demonstrate that the impact of learning is higher than the organizational structure. In other words the importance of learning from their own or others' experiences, success and failures, drawing implications, and storing their accumulated knowledge for future use is more important than a flexible, informal structure where the employees are entrusted authority, for creating and developing R&D capability

Interestingly, in this study, we could not find any direct statistical association between resource allocation, strategic planning and R&D capability. However, this does not mean that they have no relationship with creating and developing R&D capability. Rather it is likely that they influence the R&D capability via other significant variables (organizational structure, organizational learning) due to the significant covariance among them as shown in correlation analyses. Specifically, they have potentially partial effects on R&D capability, when all others are controlled for.

The findings of this study can not be taken as definite evidence because several limitations to the study results deserve commentary. First, these results reported here emerge from a local area; results may differ for firms located on different areas that are operating in different cultural, environmental and political conditions. Second, there was not an industrial separation while evaluating data; results may differ for different industries such as software, manufacturing and service. Despite these limitations, this study provides important implications from theoretical and practical perspectives. This study indicates that organizational learning and organizational structure are important variables of R&D capability; creating and developing innovation /R&D capability can lead firms to great profits.

Future research could investigate the formulation of technology and innovation strategy. Besides there are many actors affecting R&D/innovation capability; including new variables into the research model and theory could provide resourceful findings in the areas of technology and innovation management literature .

## REFERENCES


Cassiman B., Di Guardo M. C., Valentini G., (2009), "Organising R&D Projects to Profit From Innovation: Insights From Co-opetition", Long Range Planning, In Press, Corrected Proof

Chen, C. and Huang J., (2007), "How organizational climate and structure affect knowledge management—The social interaction perspective", International Journal of Information Management, Volume 27, Issue 2, Pages 104-118

Fu X., (2008), "Foreign Direct Investment, Absorptive Capacity and Regional Innovation Capabilities: Evidence from China", Oxford Development Studies, Vol. 36, No. 1.

Guan, J. and Ma N., (2003), "Innovative capability and export performance of Chinese firms", Technovation, Volume 23, Issue 9, Pages 737-747.

Jiang, X. and Li Y., (2008), "The relationship between organizational learning and firms' financial performance in strategic alliances: A contingency approach", Journal of World Business, Volume 43, Issue 3, Pages 365-379

Johnson, W. H.A. and Medcof J. W., (2007), "Motivating proactive subsidiary innovation: Agent-based theory and socialization models in global R&D", Journal of International Management, Volume 13, Issue 4, Pages 472-487.

Markham S. K., Green, S. G. and Basu R., (1991), "Champions and antagonists: Relationships with r&d project characteristics and management", Journal of Engineering and Technology Management, Volume 8, Issues 3-4, Pages 217-242.

Perez-freije, J. and Enkel E., (2007), "Creative Tension in the Innovation Process:: How to Support the Right Capabilities", European Management Journal, Volume 25, Issue 1, Pages 11-24

Radas S. and Božic L., (2009), "The antecedents of SME innovativeness in an emerging transition economy", Technovation, Article in Press.

Rank O. N., (2008), "Formal structures and informal networks: Structural analysis in organizations", Scandinavian Journal of Management, Volume 24, Issue 2, June 2008, Pages 145-161.

Reddy P., (1997), "New trends in globalization of corporate R&D and implications for innovation capability in host countries: A survey from India", World Development, Volume 25, Issue 11, November Pages 1821-1837

Romijn, H., and Albaladejo, M., (2002), "Determinants of innovation capability in small electronics and software firms in southeast England," Research Policy, vol. 31(7), pages 1053-1067.

Scott-Ladd, B.D and Chan, C.C.A., (2004), "Emotional intelligence, organizational learning and participation in decision-making: Facilitators off organizational change", *International Journal of Strategic Change*. 13: 95-105.

Söderquist K.E. and Godener, A., (2004), "Performance measurement in R&D and new product development: setting the scene", International Journal of Business Performance Management 2, pp. 107–132

Waldman D. A., Berson, Y. and Keller R. T., (2009), "Leadership and organizational learning", The Leadership Quarterly, Volume 20, Issue 1, Pages 1-3

Wang, C., Lu, I. and Chen C., (2008), "Evaluating firm technological innovation capability under uncertainty", Technovation 28, 349–363.

Wu W., (2007), "State Policies, Enterprise Dynamism, and Innovation System in Shanghai, China", Growth and Change, Vol. 38 No. 4 pp. 544–566

Yam R. C. M., Guan J. C., Pun K.F., Tang E. P. Y., (2004), "An audit of technological innovation capabilities in chinese firms: some empirical findings in Beijing, China", Research Policy, Volume 33, Issue 8, Pages 1123-1140

Yang Y., Narayanan, V.K. and Zahra S., (2008), "Developing the selection and valuation capabilities through learning: The case of corporate venture capital", Journal of Business Venturing, Article In Press.

# *STRATEGIC INTENTIONS – ORIENTATIONS & STRATEGIC DECISION MAKING*

# COGNITIVE PLASTICITY AND STRATEGIC CHANGE

**Geoffrey Lewis**
**Melbourne Business School**

**Tatiana Zalan**
**University of South Australia**

## ABSTRACT

*Much prior research on strategic change has been descriptive and provided limited theoretical understanding of the change process. The model of change developed in this paper, which draws on the cognitive model of strategic search, allows examination of the change techniques available to managers within a robust conceptual framework. Strategic change requires a switch from an evolutionary search mode based on 'cybernetic' process to a mode characterised by 'cognitive restructuring' of those involved in the strategic search process. Our model of change suggests that shifting from one mode to the other involves developing new collective cognitive structures enabling organisational members to 'change their minds' (Gardner, 2006). The techniques that can lead an organisation through this shift are categorised into three fundamental processes: changing the people, influencing cognitive structures by modifying behaviour, and directly influencing the cognitive structures of organisational members. We discuss the tools for driving the change process and offer practical recommendations for managing strategic change proactively.*

***Keywords:*** *Strategic change, cognition, cognitive restructuring, cognitive plasticity, organisational behaviour, change mechanisms.*

# INTRODUCTION

Strategic change is a complex process, stemming from strategy's dual nature (see Gavetti & Rivkin, 2007: 420). Firstly, strategy exists in managers' minds and comprises managers' mental processes that mould particular theories about the firm, its environment and the firm's place in it. Secondly, strategy is embodied in a firm's activities, resource endowments and routines. The 'world of cognition' shapes and is shaped by the 'world of action' (Tripsas & Gavetti, 2000; Gavetti & Rivkin, 2007).

Strategic decisions require managers to be 'cognitively plastic' and being able to 'reframe' their perceptions of the industry, the business, and the relationship between the two; while implementing these decisions requires these new perceptions to be translated into action. Thus, cognitive and behavioural changes are inseparable parts of a complex, unfolding process of strategic choice and action. Developing an understanding of how cognitive and behavioural changes take place, and how they can be more effectively managed, is critical to a firm's survival and the achievement of sustainable superior financial performance.
While there is no dearth of research and popular books on leading and managing change, they are essentially descriptive and offer checklists of change techniques with little or no attempt to provide theoretical explanation or understanding. The model of change developed in this paper allows examination of the change techniques available to managers within a conceptual framework informed by cognitive theory (Steinbruner, 1974; 2002).

The paper is structured as follows. We first discuss the methodology used to develop our empirically-based conceptual model. In Theoretical Foundations we briefly overview our cognitive model of strategic search, which is fully developed in our prior work (Lewis & Zalan, 2009). The model draws on the research by Gavetti and colleagues (Tripsas & Gavetti, 2000; Gavetti & Levinthal, 2004; Gavetti et al., 2005; Gavetti & Rivkin, 2007) and cognitive theory (Steinbruner, 1974; 2002). Because broad-based change of the mode of strategic search cannot be considered in isolation from the organisational context, in the final sections of the paper we discuss specific change techniques that leaders can use to guide fundamental shifts in the cognitive structures and behaviours of organisational members.

# METHOD

While this is a conceptual paper with implications for practitioners, it has its origins in research based on a longitudinal study of a large British road transport company. The study was unusual in terms of the extensiveness and intensiveness of data collection. Access was gained at the board level, and observation of management meetings at group, company and branch levels was undertaken in conjunction with on-going interviews with all of the senior managers at group and company level over a period of two years. Process data (Langley, 1999) collected using participant observation (McCall, 1969) and on-going interviews were supported by extensive analysis of internal company documents (strategic reviews, corporate plans and budgets). This approach to data collection allowed the researcher to overcome much of the methodological issues associated with research on strategic change using the cognitive lens perspective such as reliance on retrospective sense making of complex past processes often done by single informants (see Rajagopalan & Sptreitzer, 1996, for a review).

Analytical and sensemaking procedures were consistent with the recommendations of Glaser and Strauss (1967), Pettigrew (1985), Miles and Huberman (1984), Yin (1984) and Eisenhardt (1989). The raw data were analysed iteratively, and the final stage of the analysis involved linking the interpretation of the data with theories and concepts from the received literature to develop more generalised concepts – 'grounded theory' of strategic search. Problems of selective perception and interpretation were minimised by careful management of the participant-observer role and by a multimethod/multisource research design.

The subject of the study, British Road services Limited (BRS) was at the time a group of 8 regional companies with 150 branches operating a wide range of national road transport services. In 1979 the group's revenue was over £150 million, and it employed almost 10,000 people. The group was one of several composing the state-owned National Freight Corporation (NFC) which, although controlling less than 10 percent of the market, was by far the largest organisation in the British road transport industry. In 1977, the management of BRS were facing a strategic dilemma. Five years earlier, a strategy of diversification had successfully taken the business into a range of new transport services. BRS management was realising, however, that the rate at which the new businesses would grow was insufficient to compensate for the anticipated decline in traditional haulage activities. Capital constraints imposed by NFC resulted in pressures to accelerate the shrinking of the traditional business. The rate of decline became the focus of a strategic disagreement between management. Some believed that the selective reduction of haulage activities would reveal a profitable core of business. Others argued that shrinking the traditional haulage business faster than new products grew would hurt overall financial performance, because organisational contraction would jeopardize the group's key strength, a national network of marketing and operating locations. Thus a strategy had to be found that satisfied the conflicting demands of improved financial performance and avoidance of organisational contraction.

# THEORETICAL FOUNDATIONS

## Change and Strategic Search

Throughout the array of theories of social and organisational change, a consistent theme is that gradual, evolving change is punctuated by periods of radical transformation (e.g., Chandler, 1962; Miller, 1982; Miller and Friesen, 1982). As confirmed empirically by Romanelli and Tushman (1994), organisations have tradition-bound periods punctuated by non-cumulative, revolutionary breaks, or 'punctuation events'. These two types of change correspond closely to two types of strategic search which are elaborated on below.

The model developed in Lewis and Zalan (2009) advances two fundamentally different modes of strategic search which imply different assumptions about organisational plasticity and the rationality of managers:

(1) an evolutionary search mode based on a 'cybernetic' process and

(2) a mode involving 'cognitive restructuring' of search participants.

The evolutionary search mode is consistent with the notions of bounded rationality and local search in the behavioural theory of the firm (Simon, 1955, 1997; March & Simon, 1958; Cyert & March, 1963), and limited organisational and cognitive plasticity in evolutionary economics (Nelson & Winter, 1982; Nelson, 2002; Winter, 2000). Organisational behaviour is based on semi-automatic rules and routines (Nelson & Winter, 1982; Cohen et al., 1996; Feldman, 2000), whereby the core search mechanism – local search – is aimed at seeking solutions entailing incremental change to existing routines and heuristics (key search elements).

The evolutionary search mode operates within a common, or at least significantly overlapping, cognitive structure of the search participants. Teams of senior executives who make strategic decisions construct reality such that they develop a 'common mental representation' (McCaskey, 1982) operating as shared, fundamental, and often implicit beliefs and assumptions about the world and the firm's place in it (Bartunek, 1984; Carley, 1997; Gavetti & Rivkin, 2007). This common cognitive structure defines desired effects, effective causes, and beliefs about cause-effect relationships.

In our prior work we suggested that organisational behaviours and processes associated with common cognitive structures are essentially cybernetic in nature (Steinbruner, 1974; 2002). When operating in this mode, search participants (a) monitor a small number of critical variables and rely on limited information coming from established feedback channels; (b) keep goals separate and deal with them sequentially; (c) keep problems narrowly focused and fragmented; and (d) employ a repertoire of routines to deal with marginal variations in the environment. Cybernetic processes are effective when the environment can be decomposed into manageable elements (Steinbruner, 1974; 2002). The evolutionary search mode results in incremental adaptations that are effective in dealing with marginal environmental variations, but, as our research demonstrates, fail when facing 'punctuation events' (Romanelli & Tushman, 1994). Our thesis is at odds with the position of evolutionary theory that argues that radical, non-incremental strategic change can be accommodated within the conceptual apparatus of the evolutionary paradigm (see Gavetti & Levinthal, 2004; Levinthal, 1998).

The second mode of strategic search involving cognitive restructuring of the search participants is consistent with rational choice, deductive logic and high organisational and cognitive plasticity assumed by the positioning school of strategy (e.g., Ghemawat, 1991; Porter, 1996; Brandenburger & Stuart, 1996; Siggelkow, 2001). The positioning search mode requires a restructuring of the common cognitive structure of search participants, which can only come about through organisational processes that are fundamentally different from cybernetic processes. This search mode is triggered by certain conditions (e.g., environmental discontinuity or failure to meet external performance demands) and involves a complex search process that is essentially analytical in nature, but constrained by organisational politics and processes of legitimation (Pettigrew, 1985; Pfeffer, 1981). The outcome of a successful positioning search process is a new common cognitive structure within which the organisation can again operate cybernetically.

## Search Dynamics

Shifting from the evolutionary, local search mode to the positioning mode involves a complex mix of analytical, political, and legitimation processes (Quinn, 1980; Tichy, 1983; Hendry, 2000). This shift requires search participants to change from cybernetic behaviour and confront a process of cognitive restructuring. This dynamic consists of three overlapping phases:

(1) A breakdown of the common cognitive structure and supporting cybernetic behaviour. This breakdown results from the failure of managers' common cognitive structure to find a new, viable strategic position in the face of changing circumstances. The initial response is to search for strategies within the existing cognitive structure based on local search – "scanning the organisation's existing memory" (Mintzberg et al., 1976:255). Having exhausted their repertoire of routines and heuristics, search participants are faced with a 'dilemma' – that is, "a problem or question that cannot be solved or answered within the prevailing world view and therefore calls it into question" (Ackoff, 1981: 13). A crucial step in the change of search mode is to remove it from the constraints of the formal search structure in which cybernetic behaviour is anchored – for example, moving outside the formal planning process, by engaging consultants, and forming task forces or committees. In the face of an unresolved dilemma, crisis or performance demands the common cognitive structure is eventually challenged and progressively breaks down. Thus, the organisation is triggered out of the cybernetic behaviour associated with the evolutionary mode of search.

(2) A cognitive restructuring phase, during which a new cognitive structure emerges. The focus becomes the generation of new solutions and a wide range of alternatives. In organisations with dispersed power structures the attempt to gain approval to alternatives typically involves a dialectical process (Mitroff & Emshoff, 1979) of search – formulation, proposal, rejection, and

reformulation, or what Mintzberg et al. (1976: 265) termed 'failure recycle'. It is through this recycling process that new cognitive structures emerge. Depending on the power structure of the organisation (concentrated or dispersed), the process of strategic search may or may not be highly politicised.

(3) Progressive sharing of the new cognitive structure so that it gradually becomes common to all the participants in the search process. Once a new, internally consistent cognitive structure has emerged, the strategic search process moves into its next phase, and communication of the logic behind the new strategy becomes the focus of the process. Although dealing with resistance to change from organisational members after a new cognitive structure has emerged proves to be relatively easy (provided the new strategy is viable and well communicated), it often involves much organisational tension and energy.

A crucial issue is the origin of the catalyst for the shift from the evolutionary search mode to the positioning search mode. Our research, supported by a wide range of theories of cognitive behaviour and change (e.g., Argyris, 1977; Beer et al., 1990; Gardner, 2006; Kotter, 1996, 2008), shows that strategic change, involving high uncertainty about the outcome, does not occur spontaneously. The catalyst for strategic change appears to typically take two basic forms: an externally driven crisis or dilemma; or strategically proactive leadership that challenges the existing common cognitive structure. Successful leaders seem to have a 'meta-frame of reference' that encompasses the two modes of search, preventing the organisation from becoming locked into the cybernetic mode of behaviour, and guide the organisation through successive transformations.

# Managing strategic change

## Developing New Collective Cognitive Structures

The vast array of management techniques that can used to lead an organisation through the shift from one mode of search to the other can be categorised into three fundamental processes: (1) changing the people; (2) influencing cognitive structures by modifying behaviour; and (3) directly influencing the cognitive structures of organisational members.
Changing the People

Changing the individuals involved in the search process draws on a wide range of mechanisms: selection, socialisation and, perhaps, 'deselection'; the reassignment of key individuals to different roles; and promotion of individuals into key positions. This approach to change is very powerful, but managers are typically constrained in its use: dispersed power structures as well as organisational, ethical, legal considerations often limit the extent to which these mechanisms can be applied. The approach is well covered in the literature (e.g., Kanter, 1983; Pascale, 1985; Tushman, 2002; ) Schein (1984: 290), for example, points out:

> The replacement of people in key positions by people with different assumptions is a powerful way of effecting cultural change. Executive selection and staffing processes are, in this sense, powerful processes of cultural change, but they are also very slow.

Even where new organisational members can be carefully selected, however, it is unlikely that there will be a perfect match between their cognitive structures and behavioural repertoires and the requirements of the organisation (e.g., Hofstede et al., 1990). So even where the population of the organisation can be rapidly changed, managers are faced with the task of changing individuals' cognitive structures and behavioural repertoires.

People tend to be most open to change – cognitively and behaviourally plastic – when they have just joined a new organisation and so change is usually more easily brought about than with organisational members of long standing, who are likely to be entrenched in the way they think and behave. Socialisation is the generic term for a range of change processes that are applied to new entrants to organisations, organisational subunits, or occupations (see Van Maanen & Schein, 1979). Socialisation has been described as "cognitive reconstruction" (Davis, 1968: 241) and as the acquisition of the "recipe knowledge" of an organisation, which essentially consists of programmatic behaviour based on standard operating procedures and routines – the behaviour associated with the cybernetic mode of search.
The techniques of socialisation fall within the range of generic change techniques – training, communication, reinforcement of behaviour through reward structures, role modeling – although they tend to be applied in special ways, that is, treating large numbers of people alike, attending to only parts of a person, and strictly

maintaining systems of punishment and privilege (Goffman, 1961). Socialisation is a specific example of the general process by which individuals' cognitive structures are changed and draws attention to the critical role of the relationship between behaviour and cognitive structures in the process of change.

**Changing Cognitive Structures and Behaviours**

The relationship between cognitive structures and behaviour is the central element of the model of strategic change presented in this paper (Figure 1). The model consists of three rudimentary processes:

(1) An interdependence, or dynamic equilibrium, exists between cognitive structures and behaviour .

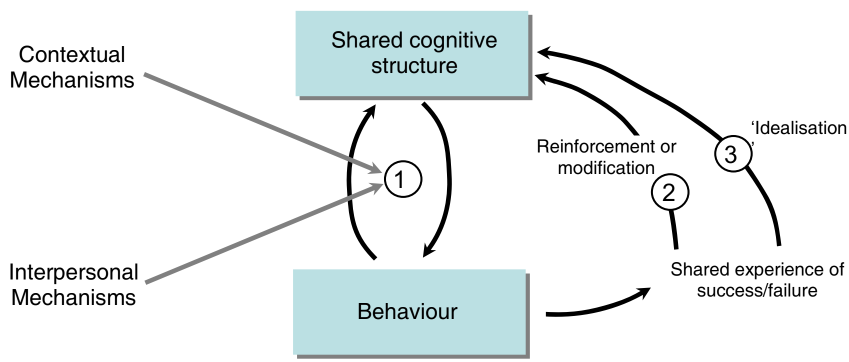
(2) Behaviour influences beliefs through the experience of success or failure. Success or failure is a subjective experience that is affected by internal and external factors, including the organisation leader. Gagliardi (1986: 121) suggests:

> In cultural change, then, the role of the leader is, above all, to create conditions under which success can visibly be achieved, even if only in a limited or partial way, and to rationalise positive events after they have happened, even if accidental.

For most people, success or failure is in large part socially defined and is, therefore, more powerfully experienced when shared with others.

(3) Through the process of "idealisation," beliefs are transformed into core values.

FIGURE 1 – A MODEL O OF CHANGE




(1) The Interdependence of Cognitive Structures and Behaviours. Managers have available to them a wide range of mechanisms with which they can influence the behaviour of people in organisations. These mechanisms can be conceptualised as 'contextual mechanisms' that operate through changing the context within which people operate and 'interpersonal mechanisms' that rely on face-to-face interaction. Contextual mechanisms include technology, work flow, and physical settings; authority structures and reporting relationships; systems (performance appraisal, rewards, planning and control, resource allocation, etc.). Interpersonal mechanisms comprise direct (that is, face-to-face) reward and punishment; role modeling; training and coaching, and peer-group pressure. These mechanisms are well covered in the existing literature on management and organisational change and will not be discussed in detail here. The issue that concerns us is how these mechanisms can be applied to bring about new cognitive structures, either directly or through the modification of behaviour.

The relationship between organisational contextual factors (technology, structure, and systems) and beliefs and behaviour is complex. People generally behave as their beliefs dictate, but the reverse is also true: behaviour affects beliefs. Sathe (1983:18) notes that, although conventional wisdom suggests that beliefs and values influence behaviour, "a considerable body of social science literature indicates that, under certain conditions, one of the most effective ways of changing people's beliefs and values is to first change their behaviour."

Research has demonstrated that inducing people to perform certain actions increases their commitment to beliefs relevant to those actions (Kiesler, 1971). For this behaviour–beliefs link to be powerful, the action should be explicit, irrevocable, volitional, and public. Salancik and Pfeffer (1977), applying these ideas to organisations, argued that people may perform the actions initially because they are required to do so by the authority system but, over time, come to believe the actions themselves are worthwhile. Thus, considerable attention has been paid to the role of ritual, ceremony, and symbolic action in organisations as mechanisms for shaping beliefs and values through repetitive behaviour (Dandridge, Mitroff & Joyce, 1980; Deal & Kennedy, 2000).

Sathe (1983:18) points out that behaviour change does not necessarily produce change in beliefs and values because of the intervening process of justification:

> People were behaving as called for by the new formal systems, but they continued to share the old beliefs and values in common and "explained" their behaviour to themselves by noting the external justifications for it.

This process of 'justification' is essentially one element of the complex processes of interdependence between behaviour and beliefs described in Festinger's (1957) theory of cognitive dissonance. If significant inconsistencies, or 'dissonance', exist between an individual's behaviour and her or his beliefs, tension will be generated. This tension, or anxiety, will cause the individual to act in one of three ways:

- change beliefs;
- change behaviour; or
- invoke various psychological 'coping mechanisms'

Coping mechanisms are well documented in the psychological literature and will not be elaborated on here. One concept that is particularly relevant to this discussion of change, however, is 'autistic restructuring'. Rather than changing behaviour or beliefs when faced with dissonance, individuals may resort to changing, in their own minds, the world or themselves. The change is not deliberate misrepresentation; rather, people are influenced by a need to believe something even though the evidence does not support the belief. Although these coping mechanisms are effective in dealing with the transient dissonances in everyday life, they tend to be dysfunctional in the long term. Over time, people tend to change either their behaviour or their beliefs.
For an individual to change their behaviour in an organisation that is tightly controlled, either because of managerial control or the nature of the work, withdrawing from the organisation completely may be necessary – an option not always perceived to be available for economic or career reasons. Changing behaviour is thus a powerful mechanism for creating changes in individuals' cognitive structures (Schein, 1984: 290):

> One can gradually produce change by coercing behaviour changes that create dissonance and, over a period of time, put people into the position of realising that they are no longer acting according to their prior assumptions. If the new behaviour has been successful and become embedded, it may be easier to change the assumptions to fit the behaviour than to undo the behaviour to fit one's original assumptions... This process may happen silently and without conscious awareness, so that one day the organisation's members find that things really are different but they don't know quite how it all happened.

Sathe (1983:19) emphasises the key role that communication can play in enhancing, or negating, the influence of behaviour on beliefs and values: "Both explicit and implicit (symbolic) communications must be relied upon to nullify external justifications for the new behaviour and persuade people to adopt new cultural beliefs and values."
Because change involves giving up beliefs, behaviours and established routines, it is a highly emotional process akin to grieving as described by Kübler-Ross (1969). Leaders are faced with the difficult task of moving the organisational members out of being stuck in 'denial' (Kübler-Ross, 1969) to more productive behaviours involving cognitive restructuring.

(2) The Experience of Success or Failure. The second rudimentary change process shown in Fig. 1 is the reinforcement or modification of cognitive structures through experiences of success or failure associated with particular behaviour. Gagliardi's (1986: 121) conceptualisation of the processes by which organisation

culture is created and changed provides insight into these rudimentary change processes. He argues that a leader uses “vision” (a specific set of beliefs) to direct organisational behaviour. This specific set of beliefs is made up of ideas of cause-effect relationships based on experience, education, and knowledge of the environment. Even though organisational members may not share the vision, the leader has the power to orient their behaviour, at least in areas where direct control can be exercised and they have legitimate authority. The experience of success causes organisational members to adopt the belief set, and it then guides their behaviour, even where direct leadership control cannot be exercised.

(3) The Process of Idealisation. The third rudimentary change process is ‘idealisation’ (Fig. 1). Gagliardi’s (1986:122) model of culture creation contends that:

> when members of the organisation have been reassured and gratified by the fact that the desired results continue to be achieved, the organisation turns its attention away from ‘effects’ (i.e. evidence of the validity of its belief) and concentrates more on identifying itself with the ‘cause’. The ‘effects’, in fact, go on out-of-sight in the life and history of the organisation, while the cause remains visible and becomes ideal, that is, something desirable and important in and of itself and not as a means to an end.
>
> Critics will be treated as heretics and doctrine will be codified and elaborated, so that the ideal becomes part of an organic ideology.
>
> The value now shared unquestioningly by all concerned, is taken more and more for granted, to the point where members of the organisation are no longer consciously aware of it. This value automatically orients their behaviour ... the value now becomes an assumption.

The process of idealisation is social in nature. The shared experience of success over time results in idealisation and a core value becoming embedded in the shared cognitive structures of the members of the organisation. Symbolic behaviour and artifacts that reflect and reaffirm the core values also become established. The culture of the organisation then drives behaviour, both directly (through prescribed behaviour patterns) and indirectly (through the shared cognitive structures).

Gagliardi’s conceptualisation of the process focuses primarily on how beliefs and values are created. The basic principles apply equally well, however, to the change of existing beliefs and values. It has been argued earlier in the paper that, while in the evolutionary search mode underpinned by cybernetic processes, organisations will continue to exhibit behaviours (routines or standard operating procedures) in the face of overwhelming evidence of their continuing failure. Idealisation explains why (Gagliardi, 1986: 122):

> ...organisational values can be seen as the idealisation of a collective experience of success in the use of a skill and the emotional transfiguration of previous beliefs.

The idealisation of past success explains why organisations are often unable to let go of obviously obsolete knowledge. Through idealisation, process beliefs become values, the dichotomy of ‘sacred-profane’ replaces the dichotomy of ‘true-false’, and the rational acceptance of beliefs gives way to the emotional identification with values.

To summarise, in Process (1) (Fig.1), organisational members behave according to the leader’s demands (to earn rewards or avoid incurring sanctions), the demands of the task or workflow, peer-group pressure, or other imperatives stemming from contextual factors. This behaviour may generate dissonance, which will act as an imperative to change beliefs. In Process (2), the experience of success will result in beliefs being either reinforced or modified. Behaviour is initially driven by the leader’s vision and the power to demand behavioural conformity. As beliefs change, the new cognitive structure becomes the primary driving force. In Process (3) (idealisation), as a result of the continuing, shared experience of success, beliefs become embedded in the shared cognitive structures as core values. Now the culture of the organisation guides thinking and behaviour.

By driving these processes of change, a leader can create a culture that will continue to act at the cognitive and behavioural levels in such a way that the processes become self-sustaining. In organisations that lack both a strong and pervasive culture and leadership, these processes will not operate. Inconsistencies among beliefs, values, and behaviour will exist, success and failure will be inconsistently defined and rewarded, and core values will not emerge.

## Techniques for Driving the Change Process

The model of change developed in the previous section allows us to examine change techniques available to managers within a robust conceptual framework (Figure 2).

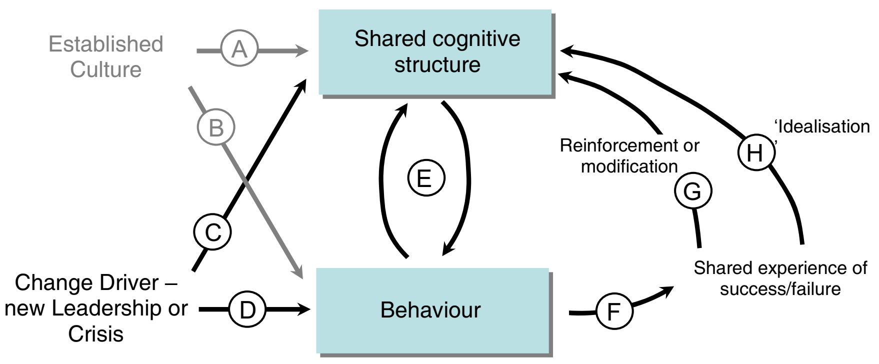
**A & C: Techniques Aimed at Directly Influencing Beliefs**

Mechanism A relates to the maintenance of an established culture rather than to change, but it acts in the same way as mechanism C. Our interest here is in change; so we will focus on mechanism C. The techniques used to drive mechanism A&C primarily involve 'instrumental' communication – informing, telling, convincing, persuading, showing, demonstrating, and teaching (Gardner, 2006).

Change mechanisms A&C are crucial, but are often overlooked in organisations, perhaps because managers take them for granted. Information, analysis, and argument can act powerfully to shape cognitive structures – or, as Gardner (2006) would put it, 'change minds'. But to be effective in developing new cognitive structures, the process must be taken outside the formal decision-making structure, because the structure is locked into the programmatic mode of behaviour. While in this mode, the organisation will monitor information selectively and interpret the filtered information within the established, shared cognitive structure.

Clear and consistent messages must be persistently and patiently communicated. Inconsistent signals, particularly if the leader's behaviour is inconsistent with what is being said, often cancel each other out. The message conveyed by consistent behaviour is more powerful than the spoken or written word.

FIGURE 2 – MECHANISMS AVAILABLE TO DRIVE CHANGE




**B & D: Contextual and Interpersonal Factors that Influence Behaviour**

As with mechanism A, mechanism B relates to the maintenance of an established culture rather than to change, but it acts in the same way as mechanism D. The wide range of techniques available to managers to influence behaviour through contextual mechanisms is listed earlier, and the application of these techniques is covered in the human resources and change management literature. In general terms, "the leadership externalises its own assumptions and embeds them gradually and consistently in the mission, goals, structures, and working procedures of the group" (Schein, 1985: 317).

Beliefs and values are translated into behaviour only when they take on real meaning. Kanter (1983: 25), for example, discusses 'action vehicles' – "mechanisms that allow the new action possibilities to be expressed. The actions implied by the changes cannot reside on the level of ideas, as abstractions, but must be concretised in actual procedures or structures or communication channels or appraisal measures or work methods or rewards."

One important technique is role modeling. The essence of this technique, which is stressed in most of the literature on organisational culture change, is that behaviour should be consistent with, reflect, and reinforce the beliefs and values being espoused. As stated earlier, behaviour will usually communicate more powerfully than words - behaviour makes the ideas tangible. Change managers must find and use role models who can "walk the talk," thus effectively demonstrating the behaviours and attitudes required by the new culture. Note that role modeling can also directly influence cognitive structures. Individuals and groups will model referent persons' beliefs and values as well as their behaviour. The role of heroes, champions, and prime movers in change has been extensively discussed in the management literature.

**E: Techniques that Reinforce the Behaviour–Beliefs Relationship associated with Cognitive Dissonance**

Communication can be used to reinforce the mechanism connecting behaviour and beliefs by negating the various devices used by individuals to dissociate their beliefs from their behaviour. Managers seeking to produce culture change must remove external 'justifications' for the new behaviour, because these justifications enable individuals to dissociate their beliefs from their behaviour—"I am only doing it because the boss makes me (pays me to do it this way, etc.)." These justifications are essentially coping mechanisms that individuals use to deal with the dissonance they face. Research findings indicate that greater change in belief takes place in situations of forced compliance if the behaviour change is reinforced with small, rather than large, rewards. For this reason, cognitive change is more likely to occur if managers do not place too much emphasis on financial rewards and other extrinsic forms of motivation. If strategic change is to be achieved, conformity to the beliefs is required, not just behavioural compliance.

**F: Techniques that Reinforce and Make Real the Experience of Success or Failure**

These techniques appear to have been somewhat overlooked in the literature on the management of change. Perhaps, as with instrumental communication, these techniques are too obvious and tend to be taken for granted.

The celebration of success and the public denouncement of failure are important devices readily available to managers. The interpersonal, and perhaps mundane, techniques of setting personal goals, discussing performance, and coaching are more important in managing change than the literature recognises. The recent emergence of executive coaching can in part be explained in these terms.

**G: Techniques that Influence the Mechanism Linking the Experience of Success or Failure with Certain Beliefs (Cause-Effect Relationships)**

Festinger, Rieken and Schachter's (1956) well-known study of a religious cult whose experience of the failure of their prophesy led them to reinforce rather than question their beliefs demonstrates that the link between success/failure and beliefs is not straightforward. An important social dimension to this link should not be overlooked: groups will engage in 'collective autistic restructuring' in the face of a shared experience of failure rather than change collectively held beliefs. Sometimes too much is at stake personally and collectively to accept the evidence of reality regardless of how convincing it might be to others.

By translating cognitive abstractions into tangible behaviour and artifacts, managers can strengthen the link between the experience of success or failure and beliefs. This mechanism is more effective if beliefs are translated into tangible rather than abstract expectations of behaviour and performance. Rewards for success and sanctions for failure should also be constantly related to the more fundamental association with beliefs: "You have succeeded not just because you met the new machining tolerances (behavioural conformity), but because meeting our customers' quality expectations is essential to the survival of the business (the cause-effect relationship – quality leads to success – is true)."

**H: Techniques that Facilitate the Mechanism of Idealisation—the 'Emotional Transfiguration' of Beliefs into Core Values**

Much has been written about the role of symbolic and affective communication in the management of cultural change. Schein (1985: 237) describes "stories, legends, myths and parables about important events and people" as secondary articulation and reinforcement techniques. Quinn (1980:7) discusses the role symbolic communication plays in the process of strategic change: "Some executives purposely undertake highly visible actions which wordlessly convey complex messages that could never be communicated as well-or as credibly-in verbal terms."

### Ten Golden Rules: Some Practical Advice for Managing Strategic Change

1. Constantly trigger shifts out of the established mindset (or cognitive structure):
   - use crises and dilemmas
   - ensure that the organisation not only remains sensitive to performance pressures – internal and external – but generate performance pressures through total quality and customer service programs
   - create an unstable equilibrium to prevent the organisation from becoming 'frozen by the emphatic success of the past'
2. Break down the standard operating procedures, routines, structures, systems, and habitual behaviour patterns that sustain the old cognitive structures by disrupting structures, systems, decision-making processes, people and portfolios, reward systems, and physical surroundings.
3. Move outside the established information channels. Don't allow the structures and systems that support the established cognitive structures to filter information from the environment (or the organisation), especially from the most important source of performance pressure – customers.
4. Use data and analysis to shock people into the recognition that the old cognitive structure is no longer working.
5. Loosen up thinking through the introduction of new people and outsiders:
   - understand that change will come from diversity and 'politics' – confrontations between individuals with different perceptions and preferred outcomes – not from conformity to collective conventional wisdom;
   - don't burn heretics at the organisational stake; nurture and co-opt them as agents of change to 'think the unthinkable and say the unsayable'.
6. Revamp employee communications mechanisms. Remember that the medium is the message. For example, pronouncements that formality in the organisation should give way to open, informal behaviour that emanate from the "Office of the Chief Executive" in a formal memo are going to have a predictable lack of effect.
7. Make extensive use of training and development programs, which must be supported by top management's active involvement.
8. Recognise the power of symbolism and ritual as mechanisms for both sustaining and changing frames of reference – often via new behaviour patterns.
9. Publicly proclaim (and reward) new behaviour and celebrate success – a "well done" or a "thank you," or simply a silent sharing of obstacles successfully overcome are still some of the most powerful change mechanisms available.
10. Finally, and most difficult of all, provide leadership – at all levels of the organisation:
    - develop a meta-frame of reference – a shared vision that will guide strategic change and energise action;
    - remember that it is the nature of change, not the magnitude of change, that is crucial; constant 'reorganisations' that do not break the organisation out of the established cognitive structures are a waste of time and effort, while small changes that demand people to 'change their minds' can be very powerful;
    - 'walk the talk' – if you don't believe in the things you are espousing enough to display them consistently in your own behaviour, nobody else will – regardless of how often, or loudly, you tell them.

## CONCLUSIONS

This article, which develops a model of the processes of change based on the cognitive model of strategic search, is grounded in established theories of cognition, strategy and change. Strategic change, it has been argued, requires a switch from an evolutionary search mode based on cybernetic process to a mode characterised by 'cognitive restructuring' of those involved in the strategic search process. We have argued that shifting from one mode to the other is essentially about developing new collective cognitive structures enabling organisational members to 'change their minds'. The techniques that can lead an organisation through this shift can be categorised into three fundamental processes: changing the people, influencing cognitive structures by modifying behaviour, and directly influencing the cognitive structures of organisational members. The model of change developed in the paper has allowed us to examine change techniques available to managers within a robust conceptual framework. It is hoped that the model will allow managers to be more confident in the application of change techniques.

## REFERENCES


Ackoff, R. L. (1981), *Creating the Corporate Future*, New York: John Wiley and Sons.

Argyris, C. (1977), Double-Loop Learning in Organizations, *Harvard Business Review,* 55(5), pp. 115-125.

Bartunek, J.M. (1984), Changing Interpretive Schemes and Organizational Restructuring: The Example of a Religious Order, *Administrative Science Quarterly,* 29, pp.355-372.

Beer, M., Eisenstat, R. A., and Spector, B. (1990), Why Change Programs Don't Produce Change. *Harvard Business Review,* November/December, pp.4-12.

Brandenburger, A. M. and Stuart, H.W. (1996), Value-Based Business Strategy, *Journal of Economics & Management Strategy,* 5(1), pp.5-24.

Carley, K. M. (1997), Extracting Team Mental Models through Textual Analysis, *Journal of Organizational Behavior*, 18, pp.533-558.

Chandler, A. D. (1962), *Strategy and Structure. Chapters in the History of American Industrial Enterprise,* Cambridge, MA: MIT Press.

Cohen, M. D., Burkhart, R., Dosi, G., Edigi, M., Marengo, L., Warglien, M., and Winter, S. G. (1996), Routines and Other Recurring Action Patterns of Organisations: Contemporary Research Issues, *Industrial and Corporate Change*, 5, pp.653-698.

Cyert, R. and March, J. G. (1963), *A Behavioral Theory of the Firm,* Englewood Cliffs, NJ: Prentice Hall.

Dandriedge, T. C., Mitroff, I., and Joyce, W. F. (1980), Organizational Symbolism: A Topic to Expand Organizational Analysis, *Academy of Management Review*, 5(1), pp.77-82.

Davis, F. (1968), Professional Socialisation as Subjective Experience: The Process of Doctrinal Conversion Among Student Nurses. In H. S. Becker, B. Geer, D. Riesman & R. S. Weiss (Eds.), *Institutions and the Person*, pp.235-251, Chicago: Aldine.

Deal, T. E. and Kennedy, A. A. (2000), *Corporate Cultures: The Rites and Rituals of Corporate Life,* New York: Basic Books.

Eisenhardt, K. M. (1989), Building Theories from Case Study Research, *Academy of Management Review*, 14(4), pp.532-550.

Feldman, M. S. (2000), Organizational Routines as a Source of Continuous Change, *Organization Science*, 11(6), pp.611-629.

Festinger, L. (1957), *A Theory of Cognitive Dissonance*. Row: Peterson.

Festinger, L., Rieken, H. W., and Schachter, S. (1956), *When Prophecy Fails*, University of Minnesota Press.

Gagliardi, P. (1986), The Creation and Change of Organisational Cultures: A Conceptual Framework, *Organization Studies* **7**(2), pp.17-134.

Gardner, H. (2006), *Changing Minds: The Art and Science of Changing Our Own and Other People's Minds*. Boston: Harvard Business School Press.

Gavetti, G. and Levinthal, D. (2000), Looking Forward and Looking Backward: Cognitive and Experiental Search, *Administrative Science Quarterly,* 45, pp.113-137.

Gavetti, G. and Levinthal, D. (2004), The Strategy Field from the Perspective of *Management Science*: Divergent Strands and Possible Integration, *Management Science* 50(10), pp.1309-1318.

Gavetti, G. and Rivkin, J.W. (2007), On the Origin of Strategy: Action and Cognition over Time, *Organization Science* 18**(**3), pp.420-439.

Gavetti,G., Levinthal, D.A. and Rivkin, J,W. (2005), Strategy Making in Novel and Complex Worlds: The Power of Analogy, *Strategic Management Journal,* 26, pp.691-712.

Ghemawat P. (1991), *Commitment. The Dynamic of Strategy*, The Free Press: New York.

Glaser, B. and Strauss, A. (1967) *The Discovery of Grounded Theory: Strategies of Qualitative Research.* London: Wiedenfeld and Nicholson.

Goffman, E. (1961), *Asylums: Essays on the Social Situation of Mental Patients and Other Inmates*, Harmondsworth, Middlesex: Penguin Book.

Hendry, J. (2000), Strategic Decision Making, Discourse, and Strategy ss Social Practice, *Journal of Management Studies,* 37(7), pp.955-977.

Hofstede, G., Neuijen, B., Ohayv, D.D., and Sanders, G. (1990), Measuring Organisational Cultures, *Administrative Science Quarterly* 35(2), pp.268-316.

Kanter, R. M. (1983), Change Masters and the Intricate Architecture of Corporate Culture Change, *Management Review*, October, pp.18-28.
Kiesler, C. A. (1972), *The Psychology of Commitment*, New York: Academic Press.
Kotter, J. P. (1996), *Leading Change,* Boston: Harvard Business School Press.
Kotter, J. P. (2008), *A Sense of Urgency*, Boston: Harvard Business School Press.
Kübler-Ross, E. (1969), *On Death and Dying: What the Dying Have to Teach Doctors, Nurses, Clergy and Their Own Families*, Macmillan: New York.
Langfield-Smith, K. (1992), Exploring the Need for a Shared Cognitive Map, *Journal of Management Studies*, 29, pp.349-368.
Langley, A. (1999) Strategies for Theorising from Process Data, *Academy of Management Review*, 24(4), pp.691-710.
Levinthal, D. A. (1998), The Slow Pace of Rapid Technological Change: Gradualism and Punctuation in Technological Change, *Industrial and Corporate Change* **7**(2), pp.217-247.
Lewis, G. and Zalan, T. (2009) Towards a Cognitive Model of Strategic Search, *Melbourne Business School Working Paper*.
March, J. G. and Simon, H. A. (1958), *Organizations*, New York: Wiley.
McCall, G. J. (1969), Data Quality Control in Participant Observation. In G. J. McCall & J. L. Simmons (Eds.), *Issues in Participant Observation: A Text and Reader*: Addison-Wesley.
Miles, M. B. and Huberman, A. M. (1984), *Qualitative Data Analysis: A Sourcebook of New Methods*, Newbury Park, CA: SAGE Publications.
Miller, D. and Friesen, P. (1982), Structural Change and Performance: Quantum vs Piecemeal Incremental Approaches, *Academy of Management Journal,* 25(4), pp.867-892.
Miller, D. (1982), Evolution and Revolution: A Quantum View of Structural Change in Organizations. *Journal of Management Studies*, 19(2), pp.131-151.
Mintzberg, H., Raisinghani, D., and Theoret, A. (1976), The Structure of 'Unstructured' Decision Processes, *Administrative Science Quarterly,* 21, pp.246-275.
Mitroff, I.I. and Emshoff, J.R. (1979), On Strategic Assumption Making: A Dialectical Approach to Policy and Planning, *Academy of Management Review,* 4(1), pp.1-12.
Nelson, R. R and Winter, S.G. (2002), Evolutionary Theorizing in Economics, *Journal of Economic Perspectives,* 16(2), pp.23-46.
Nelson, R.R. and Winter, S.G. (1982), *An Evolutionary Theory of Economic Change*, Belknap Press of Harvard University Press: Cambridge MA.
Pascale, R. T. (1985), The Paradox of Corporate Culture: Reconciling Ourselves to Socialization, *California Management Review*, XXVII(2), pp.26-41.
Pettigrew, A.M. (1985), *The Awakening Giant: Continuity and Change in Imperial Chemical Industries*, Basil Blackwell: Oxford.
Pfeffer, J. (1981), Management as Symbolic Action: The Creation and Maintenance of Organizational Paradigms, *Research in Organizational Behaviour,* 31(JAI Press).
Porter, M.E. (1996), What is Strategy? *Harvard Business Review,* November-December, pp.61-78.
Quinn, J.B. (1980), Managing Strategic Change, *Sloan Management Review*, Summer, pp.3-20.
Rajagopalan, N. and Spreitzer, G. M. (1996), Toward a Theory of Strategic Change: A Multi-Lens Perspective and Integrative Framework, *Academy of Management Review*, 22(1), pp.48-79.
Romanelli, E. and Tushman, M.L. (1994), Organizational Transformation As Punctuated Equilibrium: An Empirical Test, *Academy of Management Journal,* 37, pp.1141-1166.
Salancik, G.R. and Pfeffer, J. (1977), Who Gets Power - And How They Hold On to It: A Strategic Contingency Model of Power, *Organizational Dynamics,* Winter, pp.3-21.
Sathe, V. (1983), Implications for Corporate Change: A Manager's Guide to Action, *Organizational Dynamics,* Autumn, pp.5-23.
Schein, E.H. (1968), Organizational Socialization and the Profession of Management, *Industrial Management Review*, 9, pp.1-15.
Schein, E. H. (1984), Corporate Culture: Constraint or Opportunity for Strategy, *PA Journal of Management Issues*, 1(1), pp. 4-10.
Siggelkow, N. (2001), Change in the Presence of Fit: The Rise, the Fall, and the Renaissance of Liz Claiborne, *The Academy of Management Journal*, 44(4), pp.838-857
Simon, H.A. (1955), A Behavioural Model of Rational Choice, *Quarterly Journal of Economics,* 69, pp.99-118.
Simon, H.A. (1997), *Administrative Behaviour* (4th ed.), The Free Press: New York
Steinbruner, J,D. (1974), *The Cybernetic Theory of Decision: New Dimensions of Political Analysis*, Princeton University Press: Princeton, NJ.

Steinbruner, J.D. (2002), *The Cybernetic Theory of Decision: New Dimensions of Political Analysis*, With a New Introduction by the Author, Princeton University Press: Princeton, NJ.
Tichy, N. (1983), The Essentials of Strategic Change Management, *Journal of Business Strategy,* 3(4), pp.55-67.
Tripsas, M. and Gavetti, G. (2000), Capabilities, Cognition, and Inertia: Evidence from Digital Imaging, *Strategic Management Journal,* 21, pp.1147-1161.
Tushman, M. L. (2002), Implementing Strategic Change*,* in Tushman, M. L. (Ed.) *Winning through Innovation: A Practical Guide to Leading Organizational Change and Renewal*. Boston: Harvard Business School Publishing Corporation.
Van Maanen, J. and Schein, E. H. (1979), Toward a Theory of Organizational Socialization, In B. Staw (Ed.), *Research in Organizational Behavior,*1, pp.209-264.
Winter, S.G. (2000), The Satisficing Principle in Capability Learning, *Strategic Management Journal*, 21, pp.981-996.
Yin, R. K. (1984) *Case Study Research*, Beverly Hills, CA: Sage Publications.

# MEASURING THE LEVELS OF STRATEGIC ORIENTATIONS AND THEIR EFFECTS ON FIRM PERFORMANCE IN TURKISH FAMILY FIRMS : AN EMPIRICAL STUDY

**Cemal ZEHIR - Erkut ALTINDAG**
**Gebze Institue of Technology**

## ABSTRACT

*Nowadays, family firms use more strategic tools to increase their firm performance. These tools include some strategic orientations as market, customer, innovation, entrepreneurship, learning and relationship orientations. Family based companies need more flexible and faster organization structures to respond effectively to the customers' growing various types needs. This new concept requires new strategic alternatives for the companies. This study tries to explore the relationship between effects of strategic orientations levels on firm performance and the family firms in Turkey. Main target of this work is evaluating the effects of strategic orientations on Turkish family firms' overall performance.*

## INTRODUCTION

Today, achieving strategic competitiveness is difficult in turbulent and complex markets. These difficulties are compounded when firms do not have a clear understanding of what affects their firm performance. The heart of the strategic management process is to achieve the performance outcomes that allow firms, including family-influenced firms, to be competitive over time (Habbershon, et al., 2003).

Family businesses significantly impact to economy and the social life of a nation. The typical family business has been characterized as an organizational controlled and usually managed by multiple family members In general, management structure in the family business will determined by the top level manager. Usually at least two generations of family are found in corporate governance. Spouse, siblings, and mother / father and child in the definition of the family company enters partnerships (Shanker and Astrachan 1996; Lunsber 1999). Recent researches indicates that companies achieve their aims easily which are in family firm structure. Family firms often have concentrated ownership and / or voting rights that might enhance performance. Analyses show that family firms outperforms (Miller, et al., 2007). Family businesses may offer particularly appealing circumstances for studying certain kinds of organizational phenomena (Chrisman et al., 2003). It is hoped that this special research will contribute to filling this gap.

## FAMILY FIRMS AND STRATEGIC ORIENTATIONS

### Family Firms

The literature on family business is wide-ranging and it is difficult to find consensus on the exact definition of a family firm. However, the typical family business has been characterized as an organization controlled and usually managed by multiple family members (Shanker and Astrachan, 1996; Lansberg, 1999), often from multiple generations (Anderson and Reeb, 2003; Gomez-Mejia et al., in press).
Most of the research projects studying goals in family firms compare the goals of these types of firms to those of non-family firms in order to detect significant differences. Results in relation to this subject are

mixed. In family firms, goals related to family roles tend to be far more important than the traditional firm-value maximization goal (Sharma *et al.,* 1997; Kelly *et al.,* 2000). Among those important family roles are survival, financial independence, family harmony and family employment (Trostel and Nichols, 1982; Donckels and Frolich, 1991; Westhead, 1997). Moreover, family firms are described as being more risk-averse and less growth-oriented. They focus less on technology, creativity and innovation (Donckels and Frölich, 1991). However, most of the family firm managers believe that they are operating in a hostile external environment (Westhead, 1997).
Family firms can be viewed as a contextual hybrid—a unique combination of two sets of rules, values, and expectations: the family's and the business's (Flemons 8c Cole, 1992; Gersick, Davis, McCollom, Hampton, 8c Lansberg, 1997; Tagiuri & Davis, 1982). Family firms share certain characteristics that render them unique in terms of patterns of ownership, governance, and succession (Chua, Chrisman, & Sharma, 1999; Steier, 2003). For instance, owner-families share the desire for ownership control and the continuity of family involvement in the firm. To fully appreciate these special characteristics, it is crucial to focus on family firms where the family is likely to have considerable impact on entrepreneurial activities. We therefore define family firms as firms where one family group controls the company through a clear majority of the ordinary voting shares, the family is represented on the management team, and the leading representative of the family perceives the business to be a family firm (Naldi, et.al. ,2007).

## Market Orientation

Market orientation is a centrally important idea to marketing and a growing number of fields. Although the concept of market orientation has received considerable attention, how organizations develop a greater market orientation has received little attention. Research in marketing has identified the characteristics of market-oriented organizations (Gebhardt, 2006). Market orientation is a foundation of marketing and is increasingly important in other fields, such as strategic management. However, how organizations change to become more market oriented has received less attention. In this article, the authors conduct an in-depth, longitudinal, multifirm investigation of firms that have successfully created a market orientation. The concept of a market orientation has become increasingly important to the study and practice of management. It is the central concept of marketing (e.g., Kotler 2000).

Grounded by this in-depth understanding, they develop a theoretical model to explain how firms create a market orientation. The model identifies four path-dependent stages of change. The new findings offer new insights into how organizations develop a greater market orientation, organizational change, and the nature of market orientation, including the role of intra-organizational power and organizational learning in creating and sustaining a market orientation. The concept of a market orientation has become increasingly important to the study and practice of management. It is the central concept of marketing (e.g., Kotler 2000). Similar researches demonstrate that market-oriented organizations are characterized by a particular distribution of intra-organizational power. Power in organizations has been studied extensively (e.g., Pfeffer 1981; Van de Ven and Poole1995). This work considers an organization a collection of individuals or coalitions, both advancing their own agenda with differing degrees of success in achieving their desired outcomes. In marketing, analyses of interorganizational power play a central role in the study of distribution systems (e.g., Stern and Reve 1980).

By the way, research on market orientation has not incorporated the notion of power. Therefore, it implicitly assumes that all individuals within the organization share a common goal (e.g., Day 1999; Jaworski and Kohli 1993).For example, market orientation is a foundation of marketing and is increasingly important in other fields, such as strategic management (Gebhardt, et al., 2006). According to O'Regan and Ghobadian's (2005) adaptation of Miles and Snow's classification of company strategic orientation, a defender type company will compete on the basis of price, quality, delivery or service and operate efficiency based on a strong emphasize on maintaining existing markets (Laforet, 2007).

Entre preneurial activities in family firms do involve taking risks, but to a lesser extent than in non-family firms. If family firms generally are characterized by less internal and external formal monitoring, risk taking in family firms is likely to mean that these family firms make decision that are less baes on closely calculated risks; less grounded in a systematic, unbiased way; and with less incorporation of outsiders'e perspectives and opinions (Schulze et. al., 2001,; Naldi et al., 2007). In many global markets, speed of technological change is rapid. Especially family firm-based companies have to adopt this turbulent environment as an organic organization. Innovation-oriented firm focuses on developing key organizational competencies in resource allocation, technology, employees, operations and markets. Most prior innovation research has focused on factors that affect innovations, primarily rate, speed and benefits (Simpson, et.al., 2006).

## Innovation Orientation

In the literature and organizational context, innovation may be linked to performance and growth through improvements in efficiency, productivity, quality, competitive positioning, market share, etc. All organizations can innovate, including for example hospitals, universities, and local governments. A convenient definition of innovation from an organizational perspective is given by Luecke and Katz (2003), who wrote: “Innovation is generally understood as the successful introduction of a new thing or method; innovation is the embodiment, combination, or synthesis of knowledge in original, relevant, valued new products, processes, or services.”

An innovation-oriented knowledge structure is a set of organization-wide shared beliefs and understandings that guide and direct "all organizational strategies and actions, including those embedded in the formal and informal systems, behaviors, competencies, and processes of the firm" (Simpson et al., 2006). Most prior innovation research has focused on factors that affect innovations, primarily rate, speed and benefits. More recent research has examined innovation as a system-based, firm-wide orientation toward innovation. Along with this broader perspective comes a need for understanding outcomes of the orientation, both positive and negative. The innovation literature to date has largely relied on a handful of specific, readily calculated outcomes of innovation, with few studies examining the link between a more comprehensive innovation orientation and its organizational effects (Totterdell et al., 2002).

Though no known studies have empirically examined innovation orientation effects on consumers, Schlegelmilch et al. (2003) make a compelling argument that a strategic innovation will yield 'proactive value creation' and Totterdell et al. (2002) find a relationship between novelty and greater perceived benefits to customers.

## Entrepreneurship Orientation

In strategic management literature, entrepreneurship orientation is viewed as a learning and selection mechanism that engenders exploratory and risk-taking behavior in new product development (Lumpkin & Dess, 1996; ). Comparing the literature on both marketing and entrepreneurship orientations, Atuahene-Gima and Ko (2001) studied whether companies which are most market-oriented tend to develop products with a high degree of incorporated novelty, or whether they mainly focus on applying slight modifications to their product avoid the risks while achieving the goals.

Internal control systems are the most important mediating factors through which firm orientation affects the degree of improvement in new product development, and they can powerfully ensure that a firm's new product development activities are completed in ways that lead to the attainment of the organization's goals Unfortunately, we have little knowledge about how both entrepreneurship and market orientations affect the degree of improvement of new product development through internal control systems (Li, et al, 2006).

## Customer Orientations

Customer orientation is the set of beliefs in sales that says that customer needs and satisfaction are the priority of an organization. It focuses on dynamic interactions between the organization and customers as well as competitors in the market and its internal stakeholders. It involves a continuous improvement in business processes. It is "the business seen from the point of view of its final result, that is, from the customer’s point of view." (Drucker, P., 1994,) Customer orientation or the customer is king is a key word of the management economics, which the dependence of the enterprises on customer points out. Missing customer orientation can reduce the conversions. The causes for customer orientation lacking lie frequently in the culture, the structure and the processes of the enterprise. Customer orientation as strategy requires new processes and new organizational culture.

## Relationship Orientation

The importance of relationship marketing is reflected in the numerous advantages that have been attributed to it by prominent scholars. Inter-organisational relationships may also be beneficial in the context of supply chain management that requires the integration of the business partners in the supply chain. Relationship orientation refers to the proactive creation, development and maintenance of relationships with customers and other parties that would result in mutual exchange and fulfillment of promises at a profit. Relationship orientation may be viewed as a philosophy of doing business successfully and as an organizational culture that puts the buyer-seller relationship at the centre of a firm's strategic and operational thinking. Relationship orientation is a multi-dimensional concept that has been conceptualized by various authors to include such dimensions as communication, trust, bonding and other non-economic and social dimensions (Panayides, 2007) .

## Learning Orientation

Organizations that are competent learners are called "learning organizations". Garvin (1993) defined a learning organization as "an organization skilled at creating, acquiring, and transferring knowledge, and at modifying its behavior to reflect new knowledge and insights". Most scholars view organizational learning as a process, a cognitive enterprise, that unfolds over time, but they differ on other important matters. Some believe that behavioral change is required for learning others insist that new ways of thinking are enough (Baker, et al., 2007). Learning organization, an organization's implicit or explicit understanding of how things are done is often referred to as its theory in use. Organizational learning occurs when members of the organization act as learning agents for the organization, responding to changes in the internal and external environments of the organization by detecting and correcting errors in organizational theory in use, and embedding the results of their inquiry in private images and shared maps of organization.

### FIRM PERFORMANCE

Today, time-based competition strategy, focusing only on process standards that are not time and reduce preparation time, labor and delivery time, the flexibility to stay connected to the high quality products produced highlight capabilities requires the performance criteria (Toni et al, 1997). Each strategic orientation has various effects on growth and profitability performance in family based businesses. In various studies, the positive way strong relationships were found between the active return rate, growth in sales, new product success, increasing market share and profitability performance indicators (Narver ve Slater, 1990). In this research, family business' financial and growth performance are tried to analyse by managers or chiefs's perspectives. Firm performance is connected to effective use of performance measures in the family firm.

# METHOD

## Proposed Model and Research Hypotheses, Sample Characteristics

The main aim of this study is to evaluate the effects of strategic orientations levels on firm performance in family firms. In order to empirically investigate the hypothesis of the study, family based firms are chosen in Istanbul area. To collect the data some tools as e-mail, letter and face to face interviews are used. Minimum three members from each firm claimed to participate the research survey. As total of 200 questionnaires among over 50 firms have returned.

## Measures

All constructs were measured with existed scales from previous literature. The first of these variables is the customer orientation. This instrument used a modified version by Berthon et al (2004). This instrument has 24 statements. An instrument designed by Li, Liu (2007), was used the measure the construct of entrepreneurship orientation. The third variable is innovation orientation. This instrument is modified by Hurley and Hult (2004). The other variable is learning orientation used by Hult et al in 2003. Fifth variable is market orientation. This instrument is belong to Kohli et al (1993). The last variable is relationship orientation which is used in previos studies by Panayides.

All items were measured on a seven point Likert-type scale where 1= strongly disagree and 7= strongly agree. No reverse-scale is used. Data is evaluated by SPSS 16.0 statistical analyse program. The relationships between the all variables are tested using factor, reliability, correlation and regression analyses.

## Measure Validation

Table-1: Output of reliability analysis of each strategic orientation

| Variables | Number of Questions | Croanbach's Alfa (α) |
|---|---|---|
| **Customer Orientation** | 24* | 0,80 |
| **Entrepreneurship Orientation** | 3 | 0,69 |
| **Innovation Orientation** | 7 | 0,86 |
| **Learning Orientation** | 18 | 0,97 |
| **Market Orientation** | 19 | 0,94 |
| **Relationship Orientation** | 17 | 0,98 |

* 4 items of this measure has eliminated during analyses process.

## Tested Hypothesis, Tables and Figures

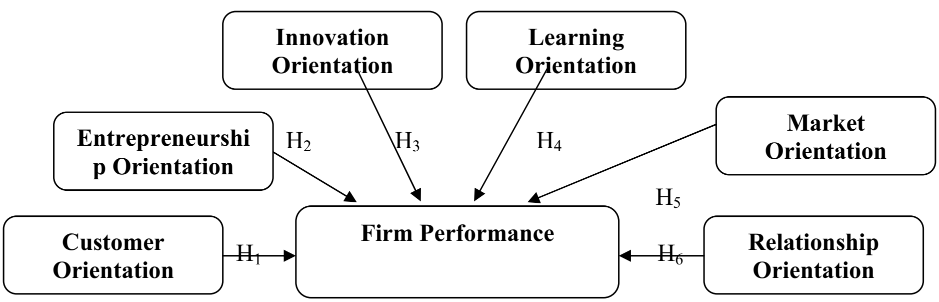



Fig.1 : Hypothesized model.

| **Table 2.** | **Standardized β** | **Sign** | **Result** |
|---|---|---|---|
| Effects of customer orientation on firm performance | 0,938 | 0,000 | **Accepted** |
| **F**= 73,456 **R²**= 0,880 | | | |

**H₁ :** There is a positive and significant relationship between customer orientation and firm performance .

| **Table 3.** | **Standardized β** | **Sign** | **Result** |
|---|---|---|---|
| Effects of entrepreneurship orientation on firm performance | 0,545 | 0,000 | **Accepted** |
| **F**=13,535 **R²**= 0,297 | | | |

**$H_2$ :** There is a positive and significant relationship between entrepreneurship orientation and firm performance .

| **Table 4.** | **Standardized β** | **Sign** | **Result** |
|---|---|---|---|
| Effects of innovation orientation on firm performance | 0,914 | 0,000 | **Accepted** |
| **F**=57,746 **$R^2$=** 0,835 | | | |

**$H_3$ :** There is a positive and significant relationship between innovation orientation and firm performance .

| **Table 5.** | **Standardized β** | **Sign** | **Result** |
|---|---|---|---|
| Effects of learning orientation on firm performance | 0,252 | 0,000 | **Accepted** |
| **F=** 29,066 **$R^2$=** 0,691 | | | |

**$H_4$ :** There is a positive and significant relationship between learning orientation and firm performance .

| **Table 6.** | **Standardized β** | **Sign** | **Result** |
|---|---|---|---|
| Effects of market orientation on firm performance | 0,447 | 0,000 | **Accepted** |
| **F=** 5,871 **$R^2$=** 0,200 | | | |

**$H_5$ :** There is a positive and significant relationship between market orientation and firm performance .

| **Table 7.** | **Standardized β** | **Sign** | **Result** |
|---|---|---|---|
| Effects of relationship orientation on firm performance | 0,734 | 0,000 | **Accepted** |
| **F=** 17,938 **$R^2$=** 0,539 | | | |

**$H_6$ :** There is a positive and significant relationship between relationship orientation and firm performance .

The all regression analyses results of empirical study shows that all strategic orientations including innovation, customer, market, learning, relationship and entrepreneurship are implementing by Turkish family firms to achieve sustainable competitive advantage.

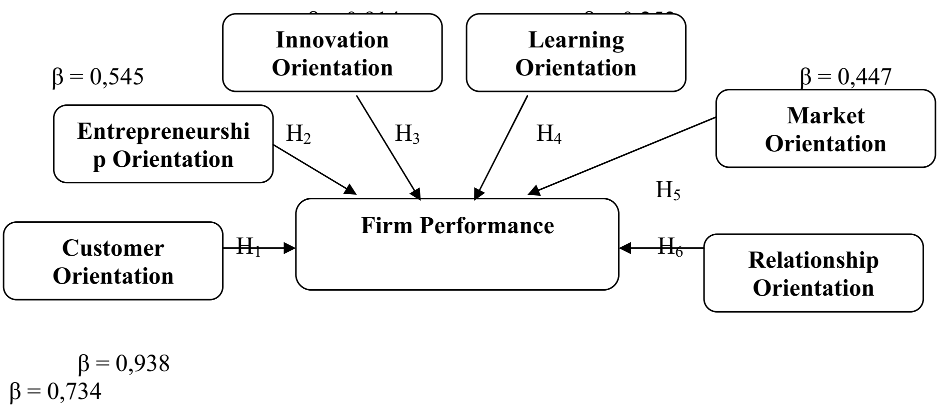



Fig. 2 : Results of the hypotheses tests (explained in discussion section)

# DISCUSSION

## Limitations and future research directions

This article has several limitations that should be kept in mind. Family firms differ on a range of dimensions and it is possible that different types of family firms show different patterns in terms of all orientations. Our data consisted of Turkish family firms and inference to other countries should be made with caution. National culture and tradition may influence especially customer and market orientation, which has implications for the generalizability of our findings. In contrast, responses from more individuals within the firms would have given a more complete picture of the firm's situation and behavior. Also our contributions to family business research open up possibilities for future research.

## Conclusion

In this article, we have focused on the effect of strategic orientations on the family based firms' performance. The results of empirical study show that all strategic orientations including innovation and entrepreneurship are implementing by Turkish family firms to achieve sustainable competitive advantage. Effects of strategic orientations evolve over time and that it is the implementation of the strategy which is truly important, rather than the classification of the strategic type. It may be possible for other strategic types to improve performance by altering their strategy profiles to be more aggressive, more focused, more thoughtful or time-consuming when implementing decisions. In conclusion, this study reveals that strategic orientations are chosen by family controlled firms to increase firm performance in Turkey. Family companies with different business orientations are compared according to their performance. The results indicate that the association between strategic orientation and performance varies depending on the type of orientation used.

We find clear evidence that the improvements in market orientation are tend to affect the firm's financial performance. In this research, all strategic orientations are connected to firm's performance's elements as profitability, revenues before taxes, growth rate in the market, employee number, new customers, innovative products or services and financial success. For instance, the success of innovative output affects to firm's competitive advantage in a turbulent market. The organizational learning is a key determinant of manufacturing without errors and low costs. Several managers change their management comprehension for creating a customer focused, market-driven strategies. Our finding that the firms which use any strategic orientation are capable to be the better performers in many markets. That's what the reason of some family firms are successful.

Briefly, our study is an important step in validating the relationship between strategic orientations and firm performance. Also it provides that Turkish family firms are tend to use modern management theories in their structural organization. In the findings in replications of our research support our findings, the message to the family firm managers is clear. In the competitive market, family firms must evaluate their performance and choose a suitable strategic orientation to achieve competitive advantage strategy. This will help to increase their profitability and growth rate in the market.

## REFERENCES


Chrisman, J.J., Chua J.H., Steier, L., (2003), "An introduction to theories of family business", Journal of Business Venturing, Pages 441-448

Chua, J. H., Chrisman, J. J., 8c Sharma, P. (1999). Defining the family business by behavior.
Entrepreneurship Theory & Practice, Summer, 19-39.

Donckels, R. and Freilich, E. (1991) Are family businesses really different? European experiences from Stratos. *Family Business Review* **4**(2), pages 149—160.

Drucker, P, *The Theory of the Business*, *Harvard Business Review*, September-October 1994, page 39

Flemons, D. G., & Cole, P. M. (1992). Connecting and separating family and business: A relational approach to consultation. Family Business Review, 5(3), 257-269.

Garvin, David A. (1993). "Building a Learning Organization." Harvard Business Review 71 (July-August): pages 78-91.

Gebhardt, G.F., Carpenter, G.S., Sherry Jr., J.F., (2006),"Creating a Market Orientation: A Longitudinal, Multifirm, Grounded Analysis of Cultural Transformation", Journal of Marketing, Vol. 70, Pages 37-55

Gersick, K. E., Davis, J. A., McCollom Hampton, M., & Lansberg, I. (1997). Generation to generation: Life cycles of the family business. Boston, MA: Harvard Business School Press.

Gils, A.V., Voordeckers, W., Heuvel, J.V.D., (2004), "Environmentel Uncertainty and Strategic Behavior in Belgian Family Firms", European Management Journal, Vol:22, No:5, pages 588-595

Gomez-Mejia, L.R., Nunez-Nickel, M., Gutierrez, I., 2001. The role of family ties in agency contracts. Academy of Management Journal 44 (1), 81 -95.

Habbershon T.G., Williams, M., MacMillan I.C., (2003), "A unified systems perspective of family firm performance", Journal of Business Venturing, Pages 451-465

Laforet, S., (2007), "Size, strategic, and market orientation affects on innovation", Journal of Business Research, Pages 1-12

Lansberg, I., (1999), "Succeeding Generations", Harvard Business School Press, Boston, MA

Li, Y, Liu, Y, Zhao, Y, (2006), "The role of market and entrepreneurship orientation and internal control in the new product development activities of Chinese firms", Industrial Marketing Management, no:35, pages 336-347

Lumpkin, G. T., & Dess, G. G. (1996). Clarifying the entrepreneurial orientation construct and linking it to performance. Academy of Management Review,21, pages *135—172.*

Miller D., Breton-Miller I., Lester R., Cannella A., (2007), "Are family firms really superior performers?" , Journal of Corporate Finance, Pages 1-30

Narver, John C., Slater, S.F. & Tietje, B.(1998), "Creating a market orientation", *Journal of Market-Focused Management,* 2/3,Pages 241-256.

Naldi , L., Nordqvist, M., Sjoberg, K., Wiklund, J., (2007), "Entrepreneurial orientation, risk taking and performance in family firms, Family Business Review, Pages 33-47

Panayides, P, (2007), "The impact of organizational learning on relationship orientation, logistics service effectiveness and performance", Industrial Marketing Management, no:36, pages 68-80

Simpson P.M., Siguaw, J.A., Enz, C.A., (2006), "Innovation orientation outcomes: The good and the bad", Journal of Business Research, 2006, Pages 1133-1141

Sinkula, J.M., Baker, W.E, Noordewier, T., (1997), "A Framework for Market-Based Organizational Learning: Linking Values, Knowledge, and Behavior", Academy of Marketing Science, No:25, Page 305

Shanker, M.C., Astrachan, J.H., (1996), "Myths and realities: family business's contribution to US economy – A framework for assessing family business statistics", Family Business Review, 9-2, Pages 107-123

Sharma, P., Chrisman, J.J. and Chua, J.H. (1997) Strategic management of the family business: past research and future challenges. *Family Business Review* 10(1), pages 1-35.

Schulze,W.S., Lubatkin, M.H., Dino, R.N., & Buchholtz, A.K., (2001), "Agency relationship in family firms: theory and evidence", Organization Science, 12 (2), Pages 85-105

Toni, A.D., Tonchia, S., "Performance Measurement Systems: Models, Characteristics and Measures", International Journal of Operations& Production Management, Vol:21, No:1/2, 2001.

Totterdell Peter, Desmond Leach, Kamal Birdi, Chris Clegg, Toby Wall, "An investigation on the contents and consequences of major organizational innovations." Int J Innov Magazine 2002;6: Pages: 343-68.

Trostel, A.O. and Nichols, M.I. (1982) Privately-held and publicly-held companies: a comparison of strategic choices and management processes. *Academy of Management Journal* 25**,** pages 47-62.

Westhead, P. (1997) Ambitions, 'External' environment and strategic factor differences between family and non-family companies. *Entrepreneurship and Regional Development* 9**,** 127-157.

# A STUDY ON THE CAUSES OF STRATEGIES' NOT LEADING TO SUCCESS

**Mehmet Ali Koseoglu**
**Menderes EDAS, Mugla, Turkey**

**Mehmet Barca**
**Sakarya University, Turkey**

**Kemal Karayormuk**
**Afyon Kocatepe University, Turkey**

## ABSTRACT

*The present study investigates the reasons behind the failure of implementing strategies. The failure of the strategies is evaluated according to results of their formulation and implementation processes. In this respect, for investigating the reasons behind the failure of the strategies questionnaires were administered to 418 managers. In light of the findings obtained, the reasons behind the failure of the strategies seem mostly to stem from the formulation process, and the most important issues in the implementation process are found out to be organizational, individual, and managerial.*

***Key Words:*** *Strategy, formulation, implementation, Turkey*

## INTRODUCTION

This study focuses on the causes of strategies' not leading to success. A study conducted by Fortune magazine revealed that 90% of the strategies are unsuccessful, and single most important cause of this is believed to be the weak application of the strategies (Waterman, et al. 1988). Moreover, though it has been widely investigated that the change is necessary for the growth of organizations, more than 70% of the change-oriented attempts as change strategies are unsuccessful (Higgs & Rowland, 2005). In addition, Raps (2004) assert that the real success rate of strategy implementation is between 10% and 30%. In this respect, for both the practitioners and academicians, it seems to be necessary to investigate why the strategies are unsuccessful.

In recent years, though there seems to be many theoretical studies on the strategy implementation process (Okumus, 2001, 2003; Okumus & Poper, 1999) and empirical studies conducted on the implementation of successful strategies and the obstacles hindering such successful implementations from occurring, most of these studies have been conducted in developing countries (e.g. Kargar & Blumenthal, 1994; Dooley, et al. 2000; Peng & Litteljohn, 2001; Thorpe & Morgan, 2007; Harrington & Kendall, 2006; Schaap, 2006; Qi, 2005) and there is a paucity of such studies in developed countries (Alashloo, et. al, 2005; Shah,2005; Hacker & Washington, 2004). In particular, these studies focus on successful strategy implementations yet do not attempt to describe the obstacles confronted with in strategy implementation processes.

For successful strategy implementation, many models have been developed in the literature (Peter and Waterman, 1982, Wernham, 1984, David, 1989, Skivington & Daft 1991, Roth et al,1991, Hrebiniak, 1992, Yip,1992, Eisenstat, 1993, Bryson & Bromiley, 1993, Sandelands, 1994, Lingle & Schieman, 1994, Okumus, 2001, Peng and Litteljohn,2001, Higgins, 2005). However, these models do not clearly discuss the extent to which the factors allowing strategies to lead to success and/or factors preventing strategies from resulting in success. That is, it has not yet shed much light on whether the strategic formulation process or strategy implementation process is more influential in terms of strategies' resulting in success or failure. Alashloo et al. (2005) attempt to categorize the reasons for the failure of strategies under four main headings: i) Planning consequences, ii) Organizational Issues, iii) Managerial Issues, iv) Individual issues. However, they do not deal with the question of which of these categories is more influential on the success of strategies.

In this respect, the main contribution of the present study is expected to determine the most influential factors preventing strategies from being successful, taking the four categories of factors (planning, organization, management, and individual) into account.

In order for this study to achieve its objective, we selected the sampling among the firms in Turkey. With the implementation of the conditions of the free market economy as of 1980, the companies in Turkey have become more liberal, more foreign investment has come to the country, and these forced the organizations to adjust themselves to emerging market conditions. These changes put Turkey among the 10 biggest developing markets. Another factor leading to the selection of sampling from Turkey is its unique cultural and historical texture. A bridge between the West and East, Turkey is a candidate country for European Union membership. These special characteristics of the country have important influences on the strategies of the organizations developed to gain a competitive advantage. On the other hand, political and economic crises experienced in the country in the last ten years have a power to direct the orientation of the organizations in the country. Hence, it is believed that the investigation of the efforts of the organizations throughout this process will reveal important results for the purpose of the present study.

Therefore, the sampling of the study consists of the managers of the organizations operating in Turkey. The questionnaire designed, which was based on the study by Alashloo, Castka and Sharp (2005) mentioned above, was administered to the top managers of the organizations selected regardless of their size.

In what follows is that the study first looks at the causes behind the failure of strategies and focuses on the obstacles encountered in the processes of strategy formulation and strategy implementation. Here, given the theoretical discussion of the causes, the hypotheses to be tested are set. Then, the results and findings of the study are discussed. In the final section suggestions for the future direction are made.

## Strategy Implementation

Alexander (1991) likens the strategic management process to a two-sided medallion. One side of the medallion is the strategy formulation describing the action plan that enables the organization to compete in specific situations; the other side represents the strategy implementation process describing how the formulated strategy is implemented. Hence, it can be argued that whether a strategy is successful or unsuccessful depends separately on these processes and their interaction. Namely, work performance is not only related to how well the strategies are formulated but also how well they are implemented. Indeed, unless successfully applied, even the strategy delicately designed and correctly predicted is almost valueless. While strategy formulation and application are functions closely connected to each other, implementation of the strategy is the most complex and time-consuming part of strategic management. Strategy implementation covers almost every aspect of the management and it needs to be started from many different points within the organization (Shah, 2005). Though the reason for the failure of strategies is viewed to be strategy implementation process in the strategic management literature, this issue has attracted less attention than the issue of strategic formulation in research (Webster, 1981, Kargar & Blumenthal, 1994). Alexander (1991) gives the reasons behind this fact as follows: strategy implementation is less glamorous than strategy formulation; many academics and practitioners tend to overlook it because of a belief that anyone can do it; people are not exactly sure what strategic management process includes, where it begins and where it ends; there are only a limited number of conceptual models of strategy implementation.

According to Hrebiniak (2005) the formulation-implementation relationship is as such: "Still, it is obvious that the execution of strategy is not merely as clear and understood as the formulation of strategy. Much more is known about planning than doing, about strategy making than making strategy work". In general, in strategic management literature and in particular, in strategy literature, strategy implementation is viewed to be different from strategy formulation and it is considered to be an issue of adjusting organizational structures and systems (Aaltonen et. al 2002). Alashloo et. al., (2005) defines strategy implementation as the explanation of how the strategy developed in a limited time should effectively be implemented to the capacities, human and financial resources of the organization. According to Reid (1989), strategy implementation is a vital process describing the opportunities of the future. From another viewpoint, strategy implementation is the collection of implementations and operations originating from the important managerial capabilities and behaviours defined for good leadership (de Kluyver & Pearce, 2003). Shah (2005) defines strategy implementation as the implementation of strategy formulation to determine the future direction of the organization. Parnell (2008) explains strategy implementation through the concepts of participation, conception, and commitment that affect the dissemination of the strategy. As it can be seen in these definitions, strategy implementation is a complex process (Schellenberg, 1983).

It is really difficult to come up with an exact definition of strategy implementation Definitions of strategy implementation are shaped according to strategy formulation, elements of organizational behaviours and its importance for the organization. Another complex issue related to strategy implementation is concerned with the factors affecting strategy implementation. There are many different opinions about this issue, as they are presented in Table 1.

**Table 1. Factors Influencing Strategy Implementation**

| Authors | Factors |
|---|---|
| Peter and Waterman (1982) McKinsey's 7S | Structure, style, staff, shared values, skills, system, strategy. |
| Wernham (1984) | Resources, confidence, others delivering what they promised, information and back-up materials |
| David (1989) | Motivation, leadership and direction skills, co-ordination |
| Skivington & Daft (1991) | Intended strategy, structure, systems, interactions, sanctions |
| Roth et al (1991) | Coordination, managerial philosophy, configuration, formalization, centralization, integrating mechanisms |
| Hrebiniak (1992) | Leadership, facilitating global learning, developing global managers, having a matrix structure, working with external companies |
| Yip (1992) | Organizational structure, culture, people, managerial processes |
| Eisenstat (1993) | competence, co-ordination and commitment |
| Bryson & Bromiley (1993) | Context, process, outcome |
| Sandelands (1994) | Commitment, time, emotion and energy |
| Lingle & Schieman (1994) | Market, people, finance, operation, adaptability, and environmental factors |
| Okumus (2001) | Content, context, process, outcome |
| Peng ve Litteljohn (2001) | Structural arrangements and the selection and development of key roles |
| Higgins (2005) | Strategy and purposes, structure, systems and processes, style of leadership, staff, resources, shared values, organizational culture, and strategic performance. |
| Birnbaum (2007) | action planning; organisational structure; human resources; the annual business plan; monitoring and control; the linkage- The Foundation for Everything Else. |

When we evaluate the factors affecting strategy implementation, it is seen that successful implementation of strategies is of great importance for all the organizations either private or public. Even the best strategies are useless unless they are applied well (Aaltonen et al 2002). In other words, strategy' breeding success can only be achieved through implementation. The subtle point here is that no matter how internally consistent is the strategic achievement concept, how many innovative elements has it got, how strong the organization is positioned against the rivals by it, what is most concerned about is how well it is implemented. And success of the implementation depends on the actors involved. For strategy implementation to be successful,

Thompson et al (2006) proposed a 9-staged process. These are:

1. Staffing the organization with the needed skills and expertise, consciously building and strengthening strategy-supportive competencies and competitive capabilities, and organizing the work effort.
2. Creating a company culture and work climate conducive to successful strategy implementation and execution.
3. Developing budgets that steer ample resources into those activities critical to strategic success.
4. Ensuring that policies and operating procedures facilitate rather than impede effective execution.
5. Using the best-known practices to perform core business activities and pushing for continuous improvement. Organization units have to periodically reassess how things are being done and diligently pursue useful changes and improvements.
6. Installing information and operating systems that enable company personnel to better carry out their strategic roles day in and day out.
7. Motivating people to pursue the target objectives energetically and, if need be, modifying their duties and job behavior to better fit the requirements of successful strategy execution.

8. Tying rewards and incentives directly to the achievement of performance objectives and good strategy execution.
9. Exerting the internal leadership needed to drive implementation forward and keep improving on how the strategy is being executed. When stumbling blocks or weaknesses are encountered, management has to see that they are addressed and rectified on a timely basis.

Feo&Jansen (2001) suggest 10 steps for strategy implementation to be successful. These are: establish a vision, agree on a mission, develop key strategies, develop strategic goals, establish values, communicate company policies, provide top management leadership, deploy goals, measure process, review progress. Also according to Wheelen and Hunger (2006) the most important activities involved in strategy implementation are: (1) involving people from all organisational levels in strategy implementation, i.e. allocating the responsibility for strategy execution; (2) developing programmes, budgets and procedures; (3) organising for strategy implementation; (4) staffing (matching the managers and employees with the strategy); and (5) leading by coaching people to use their abilities and skills most effectively and efficiently to achieve the organisational objectives.

## Obstacles in front of Strategy Implementation

The most important reason for the failure of the organization is the obstacles encountered while implementing strategies. The literature presents many problems encountered while implementing strategies (Okumuş, 2001, Dobni, 2003, Dooley et al. 2000, Freedman, 2003, Beer & Eisenstant, 2000, Hoag et al. 2002, Dobni, 2003, Galpin, 1998). For instance, Alexander (1991) mentions various reasons as obstacles: i) Implementation took more time than originally planned, ii) Unanticipated major problems arose iii) Activities were ineffectively coordinated, iv) Competing activities and crises took attention away from implementation, v) The involved employees had insufficient capabilities to perform their jobs, vi) Lower-level employees were inadequately trained, vii) Uncontrollable external environmental factors created problems, viii) Departmental managers provided inadequate leadership and direction, ix) Key implementation tasks and activities were poorly defined, x) The information system inadequately monitored activities. Wessel (1993) points out many individual barriers hindering successful implementation of strategies such as, too many and conflicting priorities, insufficient top team functions, a top down management style, interfunctional conflicts, poor vertical communication and inadequate management development.

Beer & Eisenstant (2000) see the barriers in front of strategy implementation as “six silent killers of strategy implementation” and explain them as follows: a top-down/laissez-faire senior management style, unclear strategic intentions and conflicting priorities, an ineffective senior management team, poor vertical communication, week co-ordination across functions, business or borders, and inadequate down-the-line leadership skills development.

Corboy & O’Corrbui (1999) define the obstacles as “deadly sins of strategy implementation” and go on explaining them as follows: a lack of understanding of how the strategy should be implementation, customers and staff not fully appreciating the strategy, unclear individual responsibilities in thechange process, difficulties and obstacles not acknowlledge, recoginized or acted upon, and ignoring the day-to-day business imperatives.

In addition, according to Giles (1991) there are three reasons why poor strategic planning is an obstacle to strategy implementation: i) a strategy is not really a strategy but "a mixture of budgets and management wish list"; ii) a strategy is not executable; and 3) the executors do not accept the strategy as "their own" because they did not participate in its formulation.

Alashloo et al. (2005) subsume the obstacles in front of strategy implementation under four headings. These are planning consequences, organizational issues, managerial issues and individual issues. Furthermore, they delineate what each heading consists of (Tablo 2).

**Table 2. The Impeders of Strategy Implementation**

| No | Impeders | No | Impeders |
|---|---|---|---|
| **P** | **Planning consequences** | **O** | **Organizational Issues** |
| P1 | Lack of exact strategic planning | O1 | Incompatible structure with the strategy |
| P2 | Insufficient linking of the strategy to goals. | O2 | Unsuitable resources allocation |
| P3 | Time limitation | O3 | Lack of adequate communication |

| | | | |
|---|---|---|---|
| P4 | Lack of consensus among decision makers | O4 | Lack of effective co-ordination |
| P5 | Lack of identification of major problems | O5 | Lack of adequate information system |
| P6 | Lack of effective role formulators | O6 | Incompatible organizational culture |
| P7 | Unsuitable training system | O7 | Competing activities among people |
| P8 | Unclear regulation and executive policies | O8 | Competing activities among units |
| P9 | Lack of choice of real strategy | O9 | Unsuitable evaluation and control systems |
| P10 | Lack of a national attitude to strategy | O10 | Unsuitable compensation system |
| | | O11 | Inadequate physical facilities |
| | | O12 | Lack of increative system |
| **M** | **Managerial Issues** | **I** | **Individual issues** |
| M1 | Unsuitable leadership | I1 | Lack of enough capabilities of employees |
| M2 | Lack of adequate organizational support | I2 | Resistance to change among people |
| M3 | Lack of adequate manager commitment | I3 | Resistance to change among units |
| M4 | Fear of insecurity among managers | I4 | Fear of insecurity in the new territory |
| M5 | Political factors in regard to power | I5 | Lack of understanding of the strategy |
| M6 | Unsuitable personnel management | I6 | Inadequate connection to the vision |
| M7 | Uncontrollable factors | I7 | Lack of enough motivation of employees |
| M8 | Lack of enough motivation among the managers | I8 | Lack of employee commitment |

Alashloo et al.' categorization seems to be not only very comprehensive but also very operational in order to find out the relative importance of the obstacles in the processes of strategy development and application. Therefore, the categorization is taken for granted for this study.

# Hypotheses

According to Taslak' s (2004) study of 112 textile firms in Turkey, the reasons behind the failure of strategies are sought, yet this study does not indicate whether strategy formulation or strategy implementation is more influential on the success of strategies. In addition in Turkey managers are more affiliated with strategy planning than strategy implementation and evaluation (Dinçer et. al 2006). According to the literature review following hypothesis and structural equity model was generated.

***Hypothesis 1: The factors relating strategy implementation process is more influential than those of strategy formulation process in explaining strategic failure.***

***Hypothesis 2: The obstacles in front of the strategy implementation mostly stem from individual factors.***

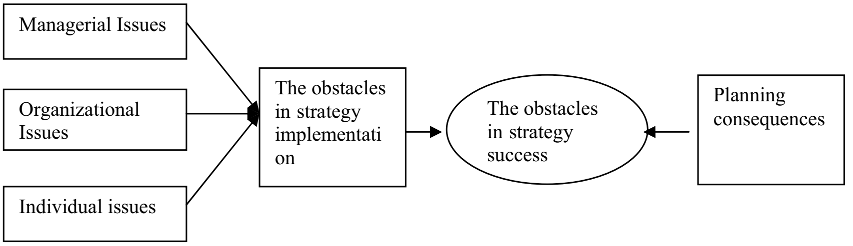



**Figure 1: Structural Equity Model**

# Methods

The survey utilized in this study contained Alashloo, Castka & Sharp's (2005) Impeders of Strategy Implementation scale. Demographic and personal items were also included, such as age, gender, management and organizational experience, and position in the firm, whether to participate a strategy planning or implementation course. The sampling of the study consists of the managers of the organizations operating in Turkey. The sample included small and large organizations, domestic and global enterprises, and manufacturing and service firms. As questionnaire administration was a challenging task, pollster teams consisting of 50 voluntary students were formed and they administered the questionnaire to the top managers of the organizations through face-to-face interview method. In order to be able to achieve a high rate of return, pollster teams administered the questionnaire to the managers in their hometowns during the mid-term holiday. The data obtained from the questionnaire was sorted out SPSS 14.0 program package and their reliability analysis was conducted. Then, before the analyses of the hypotheses, the validity of the study will be checked with confirmatory factor analysis and the hypotheses of the study were be tested through Lisrel program package.

## Respondents

The data were collected from managers in Turkey. 500 questionnaires were delivered to managers by pollster teams and 418 useful questionnaires were returned for a 83 percent response rate. Usable questionnaires entered into Excel datasheet and analyzed with the use of SPSS 14 and Lisrel 8.80.

As presented in Table I, male managers accounted for 76,8% of the total participants, while female employees accounted for 23,2%. In educational attainment, higher education accounted for 63,2% of the respondents. In management level, top managers accounted for 64,4% of the total number. The average age for the sample was 39.6 years, with respondents reporting 10,5 years of management experience and 8,9 years of experience with the present organization.

**Table 3: The Sample: Frequencies And Descriptive Data (n=418)**

| **Frequencies** | **n** | **%** |
|---|---|---|
| **Gender** | | |
| Male | 321 | 76,8 |
| Female | 97 | 23,2 |
| **Educational Attainment** | | |
| Primary | 7 | 1,7 |
| Secondary | 124 | 29,7 |
| Higher | 264 | 63,2 |
| Master Degree | 23 | 5,5 |
| **Management Level** | | |
| Lower Manager | 25 | 6,0 |
| Middle Managers | 124 | 29,7 |
| Top Managers | 269 | 64,4 |
| **Training about strategy formulation & implementation** | | |
| Yes | 218 | 52,2 |
| No | 171 | 40,9 |
| Not Sure | 29 | 6,9 |
| **Descriptive Data (Mean & Standard Deviation)** | | |
| Age | 39,6 | 8,3 |
| Management Experience | 10,5 | 6,3 |
| Experience with Organization | 8,9 | 6,2 |

Also, the organizations classification used by the European Union and the Association of Turkish Trade Chambers and Exchanges was employed (Altay & Aksaraylı, 2007) as follows: 1-9 employees represent a micro-scale, 10-49 represent a small-scale, 50-249 represent a medium-scale and 250- up represent a large-scale. According to this classification, 9.8 percent of the organizations are micro-scale, 50,2 percent are small-scale, 17.0 percent are medium-scale organizations and 23.0 percent are large-scale organizations. With regards to industry, 36.6 percent of the organizations in the study operate in the service sector, 43.7 percent of the organizations in the study operate in industrial/manufacturing sector and the remaining 17.7 percent operate in fiscal/banking sector.

## Findings

In order to be able to analyze the structural equation model, a two-stage confirmatory factor analysis was performed (Anderson & Gerbing, 1988). Standard factor loadings (t-values) of the measurement model were brought in line with the modification indices resulting from the first-stage factor analysis are presented in Table 2, along with standard deviations and Cronbach' alpha values for each item of the measurement model.

All of the alpha values exceed the minimum value of 0.70 (Nunnally, 1978). Mean values vary between 3 and 3,70. Values of all items are bigger than acceptable t value (1.96 for $p<0.05$), hence they are included in the SEM analysis.

**Table 4. Measurement model results And Means, Standart Deviation, Cronbach's alphas**

| No | Scales & Items | Std. factor load. | t-value | Mean | SD |
|---|---|---|---|---|---|
| **P** | **Planning consequences (α= 0,841)** | | | | |
| P1 | Lack of exact strategic planning | 0,61 | 15,42 | 3,36 | 1,15 |
| P2 | Insufficient linking of the strategy to goals. | 0,56 | 12,95 | 3,38 | 1,06 |
| P3 | Time limitation | 0,47 | 9,70 | 3,24 | 1,19 |
| P4 | Lack of consensus among decision makers | 0,57 | 15,00 | 3,46 | 1,10 |
| P5 | Lack of identification of major problems | 0,65 | 15,77 | 3,49 | 1,15 |
| P6 | Lack of effective role formulators | 0,65 | 17,74 | 3,36 | 1,18 |
| P7 | Unsuitable training system | 0,70 | 19,70 | 3,30 | 1,26 |
| P8 | Unclear regulation and executive policies | 0,64 | 22,41 | 3,34 | 1,23 |
| P9 | Lack of choice of real strategy | 0,56 | 17,15 | 3,47 | 1,16 |
| P10 | Lack of a national attitude to strategy | 0,65 | 14,23 | 3,26 | 1,18 |
| **O** | **Organizational Issues (α= 0,837)** | | | | |
| O1 | Incompatible structure with the strategy | 0,64 | 18,61 | 3,33 | 1,14 |
| O2 | Unsuitable resources allocation | 0,62 | 16,67 | 3,35 | 1,16 |
| O3 | Lack of adequate communication | 0,62 | 16,94 | 3,45 | 1,20 |
| O4 | Lack of effective co-ordination | 0,58 | 14,43 | 3,47 | 1,15 |
| O5 | Lack of adequate information system | 0,67 | 18,80 | 3,42 | 1,16 |
| O6 | Incompatible organizational culture | 0,67 | 21,04 | 3,27 | 1,21 |
| O7 | Competing activities among people | 0,42 | 8,58 | 3,51 | 1,08 |
| O8 | Competing activities among units | 0,39 | 8,29 | 3,49 | 1,09 |
| O9 | Unsuitable evaluation and control systems | 0,59 | 15,01 | 3,35 | 1,17 |
| O10 | Unsuitable compensation system | 0,47 | 10,04 | 3,41 | 1,12 |
| O11 | Inadequate physical facilities | 0,52 | 12,34 | 3,33 | 1,16 |
| O12 | Lack of increative system | 0,59 | 14,91 | 3,39 | 1,20 |
| **M** | **Managerial Issues (α= 0,816)** | | | | |
| M1 | Unsuitable leadership | 0,63 | 17,02 | 3,31 | 1,21 |
| M2 | Lack of adequate organizational support | 0,61 | 17,42 | 3,39 | 1,13 |
| M3 | Lack of adequate manager commitment | 0,67 | 19,98 | 3,36 | 1,18 |
| M4 | Fear of insecurity among managers | 0,59 | 14,58 | 3,37 | 1,16 |
| M5 | Political factors in regard to power | 0,56 | 14,06 | 3,48 | 1,18 |
| M6 | Unsuitable personnel management | 0,67 | 19,14 | 3,25 | 1,21 |
| M7 | Uncontrollable factors | 0,50 | 11,25 | 3,49 | 1,02 |
| M8 | Lack of enough motivation among the managers | 0,72 | 23,71 | 3,50 | 1,18 |
| **I** | **Individual issues (α= 0,848)** | | | | |
| I1 | Lack of enough capabilities of employees | 0,70 | 21,79 | 3,41 | 1,17 |
| I2 | Resistance to change among people | 0,62 | 17,62 | 3,45 | 1,15 |
| I3 | Resistance to change among units | 0,59 | 15,87 | 3,41 | 1,14 |
| I4 | Fear of insecurity in the new territory | 0,56 | 14,72 | 3,53 | 1,13 |
| I5 | Lack of understanding of the strategy | 0,68 | 20,53 | 3,62 | 1,09 |
| I6 | Inadequate connection to the vision | 0,71 | 23,49 | 3,46 | 1,11 |
| I7 | Lack of enough motivation of employees | 0,70 | 21,46 | 3,62 | 1,18 |
| I8 | Lack of employee commitment | 0,69 | 22,27 | 3,47 | 1,22 |

Goodness-of-fit indices were found to be $\chi^{2:}$ 1132,15, df: 659, p: 0,00000, $\chi^2$ /df: 1.717, Normed Fit Index (NFI): 0.968, Tucker-Lewis Index (TLI or NNFI): 0.985, Comparative Fit Index (CFI): 0.986 Root Mean Square Error of Approximation (RMSEA): 0.0415, and Goodness-of-fit indices of the measurement model were found to be acceptable levels.

The Maximum Likelihood (ML) SEM was employed. Goodness-of-fit indeces were found to be $\chi^{2:}$ 1332,51, df: 760, p: 0.000, $\chi^2$ /df: 1,7, Normed Fit Index (NFI): 0.846, Tucker-Lewis Index (TLI or NNFI): 0.975, Comparative Fit Index (CFI): 0.974 and Root Mean Square Error of Approximation (RMSEA): 0.033. The structural equation models are shown in Figure 2 with its standard factor loadings. The t-value of the model is bigger than 1.96.

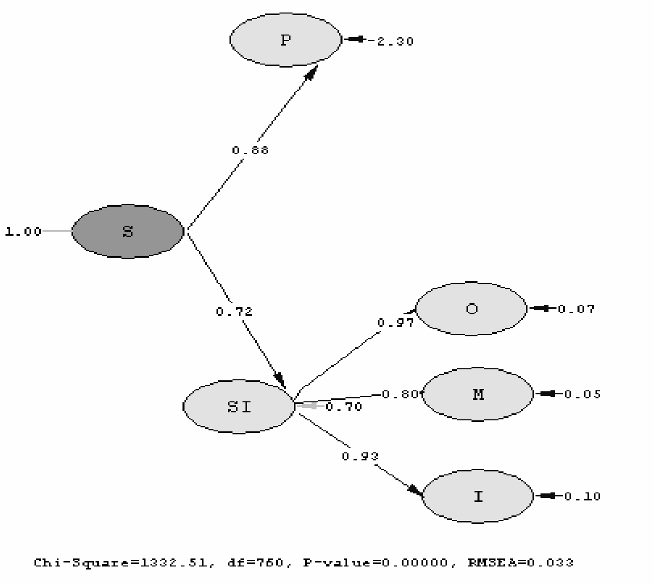



**Fig. 2: Structural Model Results**

As can be seen from the results of Structural Model, standard factor loading value of strategy planning (P) is higher than that of strategy implementation (SI). Hence, the biggest culprit for the failure of the strategies is the strategy formulation process. In this respect, the first hypothesis of the study "***The factors relating strategy implementation process is more influential than those of strategy formulation process in explaining strategic failure"*** is refuted.

When we evaluate the factors affecting strategy implementation process for the second hypothesis, standard factor loading values are sequenced from the biggest to the smallest as "O" (organizational issue), "I" (individual issue) and "M" (managerial issue). Hence, the second hypothesis "***The obstacles in front of the strategy implementation mostly stem from individual factors"*** is also refuted.

# CONCLUSION AND RECOMMENDATIONS

The present study focuses on the reasons for the failure of strategies. The success of strategies vary depending on the problems encountered in the formulation and implementation processes. In this respect, the present study reveals that planning process is a more important factor than implementation process in accounting for the failure of the strategies. The most important problems in the formulation process are "Lack of consensus among decision makers", "Lack of identification of major problems", "Lack of effective role formulators, "Unsuitable training system" and "Unclear regulation and executive policies." Moreover, it was found that the most important reason for the failure experienced during strategy implementation process is the organizational issues. The most commonly experienced problems concerning the organizational issues are "Incompatible organizational culture", "Competing activities among people", "Lack of adequate communication", "Lack of effective co-ordination" and "Lack of adequate information system".

It can be argued that there are two reasons leading us to these conclusions. First is that the Turkish managers do not know the techniques used in the strategic planning and hence they are not very willing to use them. Therefore, it can be argued that the most important reason for the failure of the strategies is the lack of training attempts. The second one is the cultural structure. Turkey reflects a collectivist culture and it is characterized as a high power distance culture (Hofstede, 1980, 1991). Lack of harmony between the cultural characteristics and organizational structure seems to be an important factor leading to failure. In this respect, organizational culture appears to be an important factor for the success of the strategies.

Another finding of this study is that all the factors mentioned are influential on the failure of the strategies followed by the Turkish organizations. In order to improve the situation, the workers should be provided with training on the strategy planning. In this way, many problems can be prevented from occurring by improving the capacities of the workers and leadership characteristics of the managers. Moreover, the organization should be structured in such a way as to open all the communications channels in the organization. Besides this, roles should be defined clearly so that no ambiguity will appear. Finally, all the tools that help the employees to participate in, understand and feel committed to strategy development should be adjusted to the organizational culture to be successful in the formulation and implementation of strategies.

The most important contribution of the present study to the literature and practice is to reveal that failure of the strategies is due to formulation process rather than implementation process. In light of the findings of the study, future research may seek answers to the following questions: "Do the factors causing strategies to be unsuccessful vary depending on the sector in which the organization is operating?", "Do the factors affecting the success of the organization vary depending on the size of the organization, the number of the staff, ownership structure, and age?" "What kind of relationship exists between the leadership characteristics and factors hindering successful implementation of strategies?" and "What is the relationship between factors affecting the successful implementation of strategies and performance?" and "Which preventive factors affect the performance more?".

## REFERENCES


Aaltonen, P., Ikavalko, H. (2002). Implementing strategies successfully, Integrated Manufacturing Systems, 13(6), 415- 418.

Al-Ghamdi, S. (1998), Obstacles to successful implementation of strategic decisions: the British experience, *European Business Review*, 98(6), 322-327.

Alashloo, F. R., Castka, P., Sharp, J. M., (2005), Towards Understanding the Impeders of Strategy Implementation in Higher Education (HE): A case of HE Institutes in Iran, Quality Assurance in Education, 13(2), 132-147.

Alexander, L. (1985), Successfully implementing strategic decisions, *Long Range Planning*, 18(3), 91-97.

Alexander, L.D. (1991), Strategy implementation: nature of the problem, in Hussey, D.E. (Ed.), International Review of Strategic Management, Vol. 2 No. 1 pp. 73-91.

Altay, A. & Aksaraylı, M. (2007). KOBİ Destek Programlarının Kuramsal Boyutunun Analizi, 4. KOBİ' ler ve Verimlilik Kongresi, İstanbul Kültür Üniversitesi, 7-8 Aralık, 35-49.

Beer, M. & Eisenstat, R. (2000). The silent killers of strategy implementation and learning, *Sloan Management Review*, 41(4), 29-40.

Bryson, J. & Bromiley, P. (1993). Critical factors affecting the planning and implementation of major projects, *Strategic Management Journal*, 14(2), 319-337.

Birnbaum, B. (2009). Strategy Implementation: Six Supporting Factors, www.birnbaumassociates.com/strategy-implementation.htm, 10.04.2009.

Corboy, M. & O'Corrbui, D. (1999), The seven deadly sins of strategy, *Management Accounting*, November, 29-30.

David, F. R. (1989). Strategic Management, New Jersey: Prentice-Hall.

de Kluyver, C., & Pearce, J., II. (2003). Strategy - a view from the top. Upper Saddle River, NJ: Prentice-Hall.

Dincer, O., Tatoğlu, E. & Glaister, K. W. (2006). The strategic planning process: evidence from Turkish firms, *Management Research News*, 29(4), 206-219

Dobni, B. (2003). Creating a strategy implementation environment, *Business Horizons*, 46(2), 43-46.

Dooley, R. S., Fryxell, G. E. & Judge, W. Q. (2000). Belaboring the Not-So-Obvious: Consensus, Commitment, and strategy implementation speed and success, Journal of Management, 26(6), 1237-1257.

Eisenstat, R. (1993), Implementing strategy developing a partnership for change, *Planning Review*, 21(5), 33-36.

Feo, J. A. D. & Janssen, A. (2001), Implementing a strategy successfully, *Measuring Business Excellence*, 5 (4), 4-6.

Freedman, M. (2003). The genius is in the implementation, *Journal of Business Strategy*, 24(2), 26-31.

Galpin, T.J. (1998). When leaders really walk the talk: making strategy work through people, *Human Resource Planning*, 21(3), 38-45.

Giles, W.D. (1991). Making strategy work, *Long Range Planning*, 24(5), 75-91.

Hacker, M. & Washington, M. (2004). How do we measure the implementation of large scale change?, Measuring Business Excellence, 8(3), 52- 59.

Harrington, R. J. (2004). The environment, involvement, and performance: Implications for the strategic process of food service firms, International Journal of Hospitality Management, 23(4), 317-341.

Harrington, R. J. & Kendall, K. W. (2006). Strategy implementation Success: The moderating effects of size and environmental complexity and tne mediating effects of involvement, Journal of Hospitality & Tourism Research, 30(2), 207- 230.

Hofstede, G. (1991). Cultures and organizations: Software of the mind. London: McGraw-Hill.

Hofstede, G. (1980). Motivation, leadership and organization: Do American theories apply abroad? *Organizational Dynamics*, 9, 42-63.

Hrebiniak, L. G. (2005). Making Strategy Work: Leading Effective Execution and Change, Upper Saddle River: Pearson Education.

Hrebiniak, L. (1992). Implementing global strategies, *European Management Journal*, 10(4), 392-395.

Higgins, J.M. (2005). The eight 'S's of successful strategy execution, Journal of Change Management, 5(1), 3-13.

Higgs, M., & Rowland, D. (2005, June). All changes great and small: Exploring approaches to change and its leadership, Journal of Change Management, 5(2), 121-152.

Hoag, B.G., Ritschard, H.V. & Cooper, C.L. (2002), Obstacles to effective organisational change, *Leadership and Organisation Development Journal*, 23(1), 6-15.

Hofstede, G. (1991). Cultures and organizations: Software of the mind. London: McGraw-Hill.

Kargar, J. & Blumenthal, R. A. (1994). Successful implementation of strategic decisions in small community banks, Journal of Small Business Managament, 32(2), 10-22.

***Liedtka, J. (2006)***. Is your strategy a duck?, *The Journal of Business Strategy*, 27(5), 32-37.

Lingle, J. & Schieman, W. (1994), Is data scatter subverting your strategy, *Management Review*, 83(5), 53-56.

Okumuş, F., (2001). Towards a Strategy Implementation Framework, International Journal of Contemporary Hospitality Management, 13(7), 327-338.

Okumus, F., (2003). A framework to implement strategies in organizations, Management Decision, 41(9), 871-882.

Okumus, F. & Roper, A. (1999). A review of disparate approaches to strategy implementation in hospitality firms, Journal of Hospitality & Tourism Research, 23(1), 21-39.

Parnell, J. A. (2008). Strategy execution in emerging economies: assessing strategic diffusion in Mexico and Peru, *Management Decision*, 46 (9), 1277-1298

Peng, W. & Litteljohn, D. (2001). Organisational communication and strategy implementation – a primary inquiry, International Journal of Contemporary Hospitality Management, 13(7), 360-363.

Peters, T. H., Waterman, R. H., In Search of Excellence, New York: Haper Collins 1982.

Qi, H. (2005). Strategy Implementation: The Impact of Demographic Characteristics on the Level of Support Received by Middle Managers, Management International Review, 45(1), 45-70.

Raps, A. (2004). Implementing Strategy, *Strategic Finance*, 85 (12), 48-53.

Reid, D. M. (1989). Operationalizing strategic planning, *Strategic Management Journal*, 10, 553-567.

Roth, K., Schweiger, M. & Morrison, J. (1991). Global strategy implementation at unit level: operational capabilities and administrative mechanisms, *Journal of International Business Studies*, 22(3), 369-402.

Sandelands, E. (1994). All talk and no action? Perish the thought, *Management Decision*, 32(5), 10-11.

Schaap, J. I., (2006), Toward Strategy Implementation Success: An Emprical Study of the Role of Senior-Level Leaders in the Nevada Gaming Industry, UNLV Gaming Research & Review Journal, 10(2), 13-37.

Schellenberg, D. S. (1983). Issues in strategy implementation: The effect of congruence among strategy, structure, and managerial performance criteria on organizational performance. Doctoral dissertation, Indiana University, IN.

Shah, A. M., 2005, The Foundations of Successful Strategy Implementation: Overcoming the Obstacles, Global Business Review, 6(2), 293-302.

Skivington, E.J. & Daft, L.R. (1991). A study of organizational framework and process modalities for the implementation of business level strategic decisions, *Journal of Management Studies*, 28(1), 45-68.

Sterling, J. (2003). Translating strategy into effective implementation: Dispelling the myths and highlighting what Works, *Strategy & Leadership*, 31(3), 27-34.

Taslak, S. (2004), Factors restricting success of strategic decisions : Evidence from the Turkish textile industry, European Business Review, Vol. 16, Iss. 2; pg. 152-164

Teare, R. E., Costa, J. & eccles, G. (1998). Relating strategy, structure and performance, *International Journal of Contemporary Hospitality Management*, 10(2), 58-77.

Thompson, A., Jr., Gamble, J., & Strickland, A., III. (2006). Strategy: Winning in the marketplace - core concepts, analytical tools, cases (2nd ed.). Boston, MA: McGraw- Hill/Irwin.

Thorpe, E. R. & Morgan, R. E. (2007). In pursuit of the “ideal approach” to successful marketing strategy implementation, European Journal of Marketing, 41(5/6), 659-677.

Waterman, R.M., Peters, T. R., Phillips, J. R., 1988, Structure is Not Organization, in T.B. Quinn, H. Mintzberg, R.M. Jones (eds), The Strategy Process: Concepts, Contents and Case. New York: Prentice Hall.

Webster, F. E., 1981, Top Management’s Concerns about Marketing, Journal of Marketing, Summer, 9-16.

Wheelen, T. L., and Hunger, D. J. (2006), Concepts in Strategic Management and Business Policy, Upper Saddle River: Pearson - Prentice Hall.

Wernham, R. (1984). Bridging the Awful Gap Between Strategy and Action, *Long Range Planning*, 17(6), 34-42.

Wessel, J. (1993), "The strategic human resource management process in practice", *Planning Review*, 21(5), 37-38.

Yip, O.S. (1992), Total Global Strategy, London: Prentice-Hall.

# A CONTENT ANALYSIS FOR VISION AND MISSION STATEMENTS OF TURKISH UNIVERSITIES


**Hulusi Dogan**
**Akdeniz University, Turkey**

**Hasan İbicioglu**
**Suleyman Demirel University, Turkey**


## ABSTRACT


*This paper is a report of a study exploring the nature and quality of Turkish universities' mision and vision statements by comparing the content of universities' statements. And a content analysis was used in this study. A total of 91 universities' mission and vision statements gotten from web pages were examined. The study results indicated that average words-length of mission statements of Turkish universities was 60.39. And average words-length of vision-statements of Turkish universities was 47.1. The shortest mission-statement of Turkish universities included 13 words, and the longest one had 319 words. The longest vision-statement of Turkish universities included 352 words, and the shortest one had 5 words. On the other hand, "community", "science", research", "education", "knowledge", "technology", "national", international", "universal", and "technology" were the most frequently used words in mission and vision-statements of Turkish universities. Moreover, "business activities and responsibilities to stakeholders" (especially for students) were heavily emphasized in mission-statements, while "public and community reponsibilities" were heavily stated in vision-statements of Turkish universities.*



***Keywords:*** *Mission-statement, vision-statement, university.*


## INTRODUCTION

The strategic management literature suggests that a carefully crafted mission or vision statement can be a key part of an effective strategic planning process. Some strategic planning models suggest that a clear concept of mission/vision is a starting point of successful competetive strategy (Campbell et al., 200: 67). In other words, mission/vision statement is an essential part of strategic planning and strategic management. But, concrete definition of the mission/vision concepts are relatively scarce. For example, while Klemm, Sanderson, and Luffman (1991: 73-78) ) are defining a mission as " a statement of the long term purpose of the organization reflecting deeply held corporate views", Ireland and Hitt (1992: 34-43) define mission statement as " a written, formal document that attempts to capture an organization's unique and enduring purpose". And its most basic level mission refers to a "reason for existence" (Abrahams, 1999: 16; Daft and Marcic, 2004: 149; Woodraw, 2006: 316). In more detail, Lucas (1998: 22-27) asserts, " Mission statement is a declaration phrase that not only encompasses the core values, core competencies, and future goals, but inspires, guides, and controls as well". Expanding further, Ackoff (1987) emphasizes that "a mission statement establishes the values, beliefs, and guidelines for the way the organization conduct its business and determines its relationships with its stakeholders-employees, customers, shareholders, suppliers, government, and the company".

On the other hand, Lipton (1996: 83-92) states that mission coupled with strategy and culture creates an organization's vision. Vision looks forward and provides an image for what the organization will be in the future (Feldner, 2006: 71). Thoms and Greenberger (1995: 272-292) define vision as a hypothetical cognitive image that pulls together beliefs about ideal ways of doing things and what the future can be. And, vision can be defined shortly as “an ideal and unique image of the future”. By using an ideal image of the future, the vision becomes the meta-goal that leader is trying to attain and an expectation can occur for people that a vision is to be consistent with the mission of an organization (Thoms and Greenberger, 1998: 4-5).

Today, it is beleived that each organization should have a mision or vision statement because of the following advantages that mission and vision statements supply for all organizations:

- to communicate a sense of the firm’s direction and purpose,
- to serve as a control mechanism to keep the firm “on track”,
- to help in making a wide range of day-to-day decisons,
- to create behavioral standards,
- to develop shared values and culture within the organization,
- to refocus an organization during a crisis,
- to balance the competing interests of different stakeholders,
- to provide a more focused basis for allocating resources,
- to inspire and motivate employees to achieve a common goal and direction and even to increase firm performance
- to reflect the culture and ideology driving an organization(see Eren, 2005; Feldner, 2006; Bartkus et al., 2000; Kemp and Dewyer, 2003; Campbell et al., 2001; Bart and Baetz, 1998; King and Cleleand, 1979; Gibson et al., 1990; Ackoff, 1987; Pearce and Robinson, 1991; Piercy and Morgan, 1994; Thompson and Strickland, 1998; Lucas, 1998; Ireland and Hitt, 1992; Klemm et al., 1991; David, 1989; Campbell and Yeung, 1991; Bart, 1996; Pearce and David, 1987; Vandijck, et al., 2007).

It is a reality that people need purpose. They need a reason for existence. And, schools or universities are no different than any other collection of people and their needs (Woodraw, 2006: 313). So, it is also a natural need for universities to have a mission or vision-statement. Moreover, it is compulsory for researchers and administrators to analyze universities’ mission and vision statements as well as other organizations’ statements.

For example, Boerema (2006: 180-202) examined mission/vision statements from 81 private schools that offered Grade 12 programs in British Columbia and Canada. In this study, Boerema analyzed the school mission/vision statements by using content analysis which is a data reduction and sense-making method. In this study, the concepts emerged from the analysis were grouped in five categories: concepts that declared the school’s distinctive beliefs, concepts that presented the school’s goals and objectives, and concepts outlining the environment, services offered, and parental involvement. Boerema found that mission/vision statement has a key role to articulate the community distinctives for schools that arise from a cultural, ethnic, or church community. Also Boerema’s findings indicated that development of academic or intellectual ability, personal development, social development, and physical development were main goals placed in mission/vision statements for the private schools. And academic excellence, athletics and extracurricular activities were most often stated services in mission/vision statements. Also findings indicated that schools sought to have a caring and respectful environment as well as mentioned a connection or partnership with parents and families.

On the other hand, Woodraw (2006: 313-327) studied to investigate the role of institutional mission in Christian Higher Education. After a review literature, Woodraw identified nine essential components of effective mission statements. He used a content analysis on 105 member institutions of the Council for Christian Colleges and Universities (CCCU) to assess the incorporation of these components into their own mission statements. Woodraw’s nine essential components for an effective mission statement were *history*, *educational philosophy*, *constituency*, *institutional strength*, *uniqueness*, *statement brevity*, *precise words*, *statements that endure*, and *breadth of communication*. In this study, he found that history is clearly appreciated by many of the institutions, and without a respect and appreciation of its past, the Christian college and university limits its future success. Second, the mission statement should reflect the institution’s educational philosophy. In Christian higher education, the opportunity to advocate a philosophy that integrates faith and learning is at the core. Third, the best mission is empowering and reflects an institution’s constituents. Particularly in Christian higher education, the religious character of an institution is ultimately dependent on its people. Fourth, the institution must identify and incorporate its strengths into its mission.

Fifth, the mission statement should be as unique and distinctive as the institution itself. No two missions, even among institutions with a similar Christian foundation, should be exactly alike. Sixth, brevity is central to a mission statement that has impact. It must inspire, but it must do it while being focused, short and simple. Seventh, wordsmithing, or language, sets the tone and spirit of a mission statement. The use of key words and certain phrases facilitates the mission in standing apart from those of other institutions. Eighth, mission statements are long-term. All of the institutional missions project a sense of long-term purpose. And finally, mission statement are widely communicated. Shortly, the finding of Woodward's study indicated that institutional mission was important to the 105 member institutions of the Council for Christian Colleges and Universities. They each have published and communicated mission statements on their Web sites that embody some or all aspects of the nine essential components of an effective mission statement.

Additionally, Davies and Glaister (1996: 261-294) got interesting results from their research on 68 mission statements of United Kingdom Universities. According to the their findings, firstly the majority of the universities produced mission-statements as part of the drawing up of the strategic plan of the university or as part of the university's strategic planning process. Second, the content analysis revealed a relatively high degree of similarity between "old" and "new" universities in terms of what was emphasized in the mission statement. Relatively large numbers of mission statements from each university sector included an inspirational purpose, business domain, responsibility to stakeholders and identified public and community responsibilities.

On the other hand, we know that many schools and universities attemp to produce a mission or vision-statement in Turkey. Furthermore, in Turkey there is a legal obligation for all public organizations to produce their strategic plan, mision and vision-statements according to the 5018 numbered Law, item 9. And, a "Regulations For Strategic Planning" was published in Turkish Governmental Journal on 26 May, 2006. So, it seems an attractive issue to examine mission and vision statements of Turkish public and private universities by a content analysis.

# METHODOLOGY

## Sample

The sample of universities used in this study was obtained from Turkish Higher Education Council. All public and private universities placed on the web page of Turkish Higher Education Council were included in the study. And a total of 91 universities which have mission-vision statements on their web pages, 67 from 94 public universities and 24 from 38 private ones, were examined in the study. In other words, 91 (69%) of 132 Turkish universities were included in the study.

## Procedure

Content analysis was used to analyze the mission/vision statements. The procedure has been considered a reputable approach for analyzing communication contents for many years. Indeed, several studies have used this tool to study web content (Bartkus et al., 2004: 393-401; Woodraw, 2006: 313-327; Boerema, 2006: 180-202; Singh et al., 2003: 63-80; Bartkus et al., 2002: 423-429; Ju-Pak, 1999: 207-231). Each university's "Home" page was accessed using the web address provided by www.yok.gov.tr or www.google.com.tr. If a mission/vision statement could not be found on this page, the university's "About US", "Strategic Plan/Planning" page or a search engine was used to try to find the statements. As seen from Table 1, 33 (36.3%) universities placed mission-vision statements on their first/home pages under "mission-vision" or "strategic plan" title acecessed by one-click. 48 (52.7%) universities, 26 from public and 22 from private ones, placed mission-vision statements (under "about us" or "about university") on their second pages accessed by two clicks. And 10 (11%) universities, 8 from public and 2 from private ones, placed their mission-vision statements on the third pages (after opnening the pages of "about us/universty" and "foundation story/quality management/strategy development office") accessed by three clicks. Universities mission-vision statements were downloaded or written down from their web pages for a content analysis.

**Table 1. University Missions and Visions on Web Pages**

| | Home Page (mission-vision statement-strategic plan) (one click) | About us-about university/mission-vision statement (two clicks) | About us-about university/foundation story-quality management–strategy development office/mission-vision statement (three clicks) |
|---|---|---|---|
| **Public University (67)** | 33 (49.3%) | 26 (38.8%) | 8 (11.9%) |
| **Private University (24)** | - | 22 (91.7%) | 2 (8.3%) |
| **All (91)** | 33 (36.3%) | 48 (52.7%) | 10 (11.0%) |

Content analysis, or qualitative method is a data reduction and sense-making (method) that takes a volume of qualitative material and attempts to identify core consistencies and meanings through coding of textual material. Content analysis can be used for many purposes, including to reveal the cultural patterns of individual, group, institutional, or social attention. Although there are many forms of content analysis, analysis of the evaluation catalogues is in the form of descriptive content analysis (Boerema, 2006: 186; Patton, 2002: 453; Hodson, 1999; Weber, 1990: 9; Neuendorf, 2002).

As Boerema's method (2006: 180-202) for the content analysis of private school mission statements, a sample of 10 mission and 10 vision statements was initially read and a set of concepts was compiled. All of the statements were then read, and the themes that appeared in the statements were coded. As the coding process continued, new concepts were added to the original list of concepts. A second reading was then made of all the statements to ensure that the full range of themes was identified in each statement. Finally, the list of concepts reviewed and consolidated into 33 themes for mission statements and 26 themes for vision statements. These 33 and 26 themes were then reviewed and put into four categories: values and beliefs (e.g. ethics, Atatürk, value, enironment, peace, human-humanist, secular), business domain (e.g. research, education, teaching, knowledge, science, student) inspirational purpose (e.g. quality, leader, creative, innovative, world, international), and public and community responsibilities (e.g. community, culture, national).

# RESULTS

Mission statements from 91 universities, 67 from public universities and 24 from private universities, were analyzed. As seen from Table 2, analysis results indicate that mission-statements of Turkish private universities are longer than those of Turkish public universities. The shortest mission-statement in public universities includes 13 words (in Turkish);

"To increase economic, cultural and social wealthiness of humanity through its education and scientific researches."
but the shortest one in private universities has only 19 words (in Turkish);

"To assist in improving health-human power by educating persons who aims to serve for humanity and his country which is making progress in modern science."

Similarly, the longest mission-statement in private universities includes 319 words, but the longest-one in public universities has 207 words. Table 2 shows that average words-length of mission statements of Turkish private universities is 71.7 which is over general average, 60.39. But the average words-length of mission statements of Turkish public universities is 56.3 which is under general average, 60.39.

**Table 2. Words-Length of University Visions and Misions**

| **Item** | **Public University (67)** | **Private University (24)** | **Total (91)** |
|---|---|---|---|
| *Average words-length of mission-statements* | *56.34* | *71.70* | *60.39* |
| The shortest mision-statement | 13 words | 19 words | 16.0 |
| The longest mision-statement | 207 words | 319 words | 263.0 |
| **Item** | **Public University (64)** | **Private University (21)** | **Total (85)** |
| *Average words-length of vision-statements* | *48.21* | *43.76* | *47.11* |
| The shortest vision-statement | 5 words | 5 words | 5 |
| The longest vision-statement | 352 words | 151 words | 251.5 |

On the other hand, a contrary position exists in vision-statements of universities. As seen from Table 2, vision-statements of Turkish public universities are longer than those of Turkish private universities. Average words-length of vision-statements of Turkish private universities is 43.7 which is under general average, 47.1. But the average words-length of vision-statements of Turkish public universities is 48.2 which is over general average, 47.1. The longest vision-statement of Turkish public universities has 352 words, the longest one of Turkish private universities includes only 151 words. Addionally, the shortest vision-statements of both public and private universities are composed of five words (in Turkish):

"To be a world university in Anatolia." (public one)

"Leader university shaping future's world." (private one)

Mission and vision-statements of universities were also examined by key-word analysis. Key-word analysis for university mission-statements indicated that "community" was the most frequently used word in Turkish universities' mission-statements (Table 3). And sequentially, "science-scientific", "research", "value", "knowledge", "education", "culture-cultural", "technology", "universal" followed "community" as the most frequently used words in mission-statements. Interestingly, "community" was the most frequently used word in public university mission-statements. But, the most frequently used word in private universty mission-statements was "science-scientific". The first ten words most frequently used in public university mission-statements were sequentially "community", "science-scientific", "value", "research", "knowledge", "culture-cultural", "technology", "universal-education", "national", "modern" and "teaching". And the first ten words most frequently used in private university mission-statements were sequentially "science-scientific", "community", "knowledge", "research", "education", "value", "world", "modern", "technology-universal-teaching", and "vocational". In other words, "culture" word was in the first ten words of public university mission-statements while not in the first ten words of private university mission-statements. Additionally, "vocational" word was in the first ten words of private university mission-statements, but not in the first ten words of public university mission-statements.

## Table 3. Frequency of Mission Statement Concepts

| Words | Public University (67) frequncy (rank) | Private University (24) frequency (rank) | All (91) frequency (rank) |
|---|---|---|---|
| Community | 90 (1) | 26 (2) | 116 (1) |
| Science-Scientific | 74 (2) | 32 (1) | 106 (2) |
| Research | 53 (4) | 21 (4) | 74 (3) |
| Value | 56 (3) | 17 (6) | 73 (4) |
| Knowledge | 51 (5) | 22 (3) | 73 (4) |
| Education | 38 (8) | 19 (5) | 57 (5) |
| Culture-cultural | 47 (6) | 8 (12) | 55 (6) |
| Technology | 43 (7) | 11 (9) | 54 (7) |
| Universal | 38 (8) | 11 (9) | 49 (8) |
| National | 34 (9) | 3 (16) | 37 (9) |
| Modern | 24 (10) | 12 (8) | 36 (10) |
| Teaching | 24 (10) | 11 (9) | 35 (11) |
| World | 21 (11) | 14 (7) | 35 (11) |
| Art-artistic | 24 (10) | 7 (13) | 31 (12) |
| International | 20 (12) | 7 (13) | 27 (13) |
| Creative | 17 (14) | 8 (12) | 25 (14) |
| Student | 15 (15) | 9 (11) | 24 (15) |
| Quality | 18 (13) | 6 (13) | 24 (15) |
| Atatürk | 15 (15) | 8 (12) | 23 (16) |
| Environment | 10 (18) | 11 (9) | 21 (17) |
| Respect | 14 (16) | 5 (15) | 19 (18) |
| Vocational | 8 (20) | 10 (10) | 18 (19) |
| Entrepeneur-ship | 9 (19) | 7 (13) | 16 (20) |
| Freedom | 8 (20) | 7 (13) | 15 (21) |
| Leader-leadership | 10 (18) | 5 (15) | 15 (21) |
| Ethics | 11 (17) | 4 (16) | 15 (21) |
| Solution | 9 (19) | 3 (17) | 12 (22) |
| Skill | 6 (22) | 5 (15) | 11 (23) |
| Democrasy-democratic | 5 (23) | 5 (15) | 10 (24) |
| Innovative | 4 (24) | 6 (14) | 10 (24) |
| Collaboration | 7 (21) | 2 (18) | 9 (25) |
| Secular | 6 (22) | 1 (19) | 7 (26) |
| Critical | 1 (25) | 5 (14) | 6 (27) |
| Expert | 1 (25) | 4 (15) | 5 (28) |
| Peace | 1 (25) | 2 (17) | 3 (29) |

On the other hand, key-word analysis for university vision-statements indicated that "education" was the most frequently used word in Turkish universities' vision-statements (Table 4). And sequentially, "science-scientific", "research", "world", "teaching", "technology", "community", "national", "international" followed "education" as the most frequently used words in vision-statements of Turkish universities. "Education" was the most frequently used word in vision-statements for both public and private universities.

But the rank for other words change. As seen form Table 4, The first ten words-most frequently used in public university vision-statements were sequentially "education", "science-scientific", "research", "technology", "teaching", "world", "national", "international", "community", and "art". And the first ten words-most frequently used in private university vision-statements were sequentially "education", "world", "science-scientific", "teaching", "community", "knowledge", "research", "modern", "technology", and "quality". In other words, seven words were common; "education", "science", research", "teaching", "technology", "world" and "community". But, three words; "national", "international" and "art" were in the first ten of public universities and not in the first ten of private ones; and "knowledge", "modern", and "quality" were in the first ten of private universities and not in the first ten of public ones for vision-statements. As an interesting finding, Table 4 indicates that "leader-leadership" and "sports" words were not used in vision statements of private universities.

## Table 4. Frequency of Vision Statement Concepts

| **Words** | **Public University (64)** frequncy (rank) | **Private University (21)** frequncy (rank) | **Total (85)** frequncy (rank) |
|---|---|---|---|
| Education | 65 (1 ) | 22 (1) | 87 (1) |
| Science-Scientific | 56 (2) | 15 (3) | 71 (2) |
| Research | 54 (3) | 11 (5) | 65 (3) |
| World | 41 (6) | 19 (2) | 60 (4) |
| Teaching | 43 (5) | 13 (4) | 56 (5) |
| Technology | 46 (4 ) | 7 (7) | 53 (6) |
| Community | 32 (9) | 13 (4) | 45 (7) |
| National | 38 (7) | 4 (9) | 42 (8) |
| International | 33 (8) | 3 (10) | 34 (9) |
| Knowledge | 20 (13) | 13 (4) | 33 (10) |
| Modern | 21 (12) | 10 (6) | 31 (11) |
| Student | 25 (11) | 3(10) | 28 (12) |
| Art- artistic | 27 (10) | 1 (11) | 28 (12) |
| Quality | 18 (15) | 7 (7) | 25 (13) |
| Culture-cultural | 19 (14) | 5 (8) | 24 (14) |
| Value | 16 (17) | 6 | 22 (15) |
| Respect | 17 (16) | 4 (9) | 21 (16) |
| Human-humanistic | 18 (14) | 1 (11) | 19 (17) |
| Universal | 10 (17) | 3 (10) | 13 (18) |
| Leader-leadership | 13 (18) | - | 13 (18) |
| Innovative | 7 (20) | 4 (9) | 11 (19) |
| Creative | 7 (20) | 3 (10) | 10 (20) |
| Sports | 10 (19) | - | 10 (20) |
| Environment | 5 (21) | 3 (10) | 8 (21) |
| Atatürk | 1 (23) | 5 (8) | 6 (22) |
| Ethics | 2 (22) | 4 (9) | 6 (22) |
| Peace | 1 (23) | 1(11) | 2 (23) |
| Expert | - | 1 11) | 1 (24) |

Mission statements from 91 universities were analysed and collected in four categories according to emphasis given in their mission content. Table 5 indicates the results of the content analysis of the ninety-one mission-statements. An "inspirational purpose" was identified in half (50.5%) of the mission-statements. 14 (58.3%) private universities and 32 (47.8%) public universities attempted to place an inspirational emphasis in university mission. And as seen from Table 5, about half (48.4%) of the mission statements identified a set of values and beliefs, while public and community responsibilities of universities were identified in a large number of mission statements (56.0%). Universities' business scope and activities, especially responsibilities to students were emphasized in 78 (85.7) mission-statements. Except the last one, public and community responsibilities, private universities were further than public universities in all categories according to the percentage assessment.

**Table 5. Content Analysis of University Mission-Statements**

| | Public) Universities (67) No. | % | Private Universities (24) No | % | All Universities (91) No. | % |
|---|---|---|---|---|---|---|
| Inspirational purpose | 32 | 47.8 | 14 | 58.3 | 46 | 50.5 |
| Business Domain-responsibility to stakeholders | 54 | 80.6 | 24 | 100 | 78 | 85.7 |
| Values and Beliefs Included | 30 | 44.8 | 14 | 58.3 | 44 | 48.4 |
| Public and Community Responsibilities | 41 | 61.2 | 10 | 41.7 | 51 | 56.0 |

The content analysis of university vision-statements has interesting findings (Table 6). Contrary to mission-statements, public and community responsibilities were heavily emphasized in university vision-statements (82.3%). But, only one-third of the vision-statements attempted to indicate the values and beliefs of the university. University's business scope and activities were described in just 59 (69.4%) vision-statements. And finally, "inspirational purpose" was identified in 51 (60%) vision-statements.

**Table 6. Content Analysis of University Vision-Statements**

| | Public) Universities (64) No. | % | Private Universities (21) No | % | All Universities (85) No. | % |
|---|---|---|---|---|---|---|
| Inspirational purpose | 36 | 56.3 | 15 | 71.4 | 51 | 60.0 |
| Business Domain-responsibility to stakeholders | 49 | 76.6 | 10 | 47.6 | 59 | 69.4 |
| Values and Beliefs Included | 18 | 28.1 | 8 | 38.1 | 26 | 30.6 |
| Public and Community Responsibilities | 58 | 90.6 | 12 | 57.1 | 70 | 82.3 |

The percentage values in Table 6 show that rather more public universities than private universities attempt to emphasize "public and community responsibilities" and "business activities" of the university in vision-statements. On the other hand, the findings-percentage values in Table 6 also indicate that more private universities than public universities attempt to emphasize "inspirational components" and "values and beliefs" of the university in their vision-statements.

# CONCLUSIONS

One of the basic findings of this study is that almost all universities in Turkey have mission and vision statements and they attempt to exhibit these statements on their web pages. We have managed to reach 91 (69%) universities' misison/vision statements from their web pages. According to the research findings, 36.3 percent of the universities placed mission-vision statements on their first/home pages. 52.7 percent of the universities placed mission-vision statements on their second pages, and 11 percent placed their mission-vision statements on the third pages accessed by three clicks. Mission and vision statements of Turkish universities are generally exhibited under the titles of "about us", "about university", "introduction", "strategic plan-planning", "quality management", "activity report" on web pages.

Study results indicate that average words-length of mission statements of Turkish universities is 60.39; 56.3 for public universities and 71.7 for private universities. The shortest mission-statement in public universities includes 13 words, and 19 words in private universities. The longest mission-statement in private universities includes 319 words, and 207 words in public universities. Average words-length of vision-statements of Turkish universities is 47.1; 48.2 for public universities and 43.7 for private universities. The longest vision-statement in public universities includes 352 words, and 151 words in private universities. The shortest vision-statement for both public and private universities includes only 5 words.

According to the study results, “community”, “science”, research”, “education”, “knowledge”, “technology”, “national”, international”, “universal”, “technology” were the most frequently used words in mission and vision-statements of Turkish universities. This is a similar finding with Davies and Glaister’s (1996: 261-294) research. Because their research on mission-statements of United Kingdom universities indicated that the most frequently used words in mission-statements were also “research”, “international”, “teaching”, “quality”, “national”, “community”, and “learning”.

Another findings indicate that “business activities and “responsibilities to stakeholders” (especially for students) are heavily emphasized in mission-statements, while “public and community reponsibilities” stated in vision-statements of Turkish universities. Additionally, more private universities than public universities attempt to emphasize “inspirational components” and “values and beliefs” of the university in their vision-statements. But, more public universities than private universities attempt to emphasize “public and community reponsibilities” in their mission statements.

Finally, it must be known that some limitations exist in this study for practitioners and readers to interpret the results. At first, the study includes the analysis of mision and vision-statements of Turkish universities and the results reflect the nature of these universities’ mission and vision statements, not a trend for all organizations. And the model-content analysis is fraugh with difficulties, thus it requires continued validation and further applications. So, the model needs to be tested in further researches. In other words, additional researches using the same or other instruments in other schools, universities are needed to explore the nature and character of mision and vision statements.

## REFERENCES


Abrahams, J. (1999), *The Mission Statement Book*, Berkeley, CA: Ten Speed.

Ackoff, R. (1987), Mission Statements, *Planning Review*, 15 (4), pp. 30-31.

Bart, C.K. (1996), The impact of mission statements of firm innovativeness, *International Journal of Technology Management*, 11 (5), pp. 479-493.

Bart, C.K. and Baetz, M.C. (1998), The Relationship Between Mission Statements and Firm Performance: An Exploratory Study, *Journal of Management Studies*, 35 (6), pp. 823-853.

Bartkus, B., Glasman, M. and McAfee, R. B. (2000), Mission Statements: Are They Smoke and Mirrors?, *Business Horizons* (November-December), pp. 23-28.

Bartkus, B., Glasman, M. and McAfee, R. B. (2002), Do Large European, US and Japanese Firms Use Their Web Sites To Communicate Their Mission?, *European Management Journal*, 20 (4), pp. 423-429.

Bartkus, B., Glasman, M. and McAfee, R. B. (2006), Mission Statement Quality and Financial Performance, *European Management Journal*, 24 (1), pp. 86-94.

Boerema, A. J. (2006), An Analysis of Private School Mission Statements, *Peabody Journal of Education*, 81 (1), pp. 180-202.

Campbell, A. and Yeung, S. (1991), Creating a sense of mission, *Long Range Planning*, 24 (4), pp. 10-20.

*Campbell, D., Shrives, P. and Saager-Bohmbach, H. (2001), Voluntary Disclosure of Mission Statements in Corporate Annual Reports: Signaling What and To Whom?,* Business and Society Review*, 106 (1), pp. 65-87.*

Daft, R. L. and Marcic, D. (2004), *Understanding Management* , 4th Ed., Mason, OH: South-Western.

David, F.R. (1989), How companies define their mission?, *Long Range Planning*, 22 (1), pp. 90-97.

Davies, W. S. and Glaister, W. K. (1996), Spurs to Higher Things? Mission Statements of UK Universities, *Higher Education Quarterly*, 50 (4), pp. 261-294.

Eren, E (2005), Stratejik *Yönetim ve İşletme Politikası*, Beta Ya., 7. Baskı, İstanbul.

Feldner, S. B. (2006), Living Our Mission: A Study of University Mission Building, *Communication Studies*, 57 (1), pp. 67-85.

Gibson, K.C., Newton, D.J. and Cochran D.S. (1990), An empirical investigation of the nature of hospital mission statements", *Health Care Management Review*, 15 (3), pp. 35-45.

Hodson, R. (1999), *Analyzing Documentary Accounts*, Thousand Oaks, CA: Sage.

Ireland, R. and Hitt, M. (1992), Mission Statements: Importance, challenge and recommendations for development, *Business Horizons,* 35 (3), pp. 34-43.

Ju-Pak, K. (1999), Content dimension of web adverstising: a cross-national comparison, *International Journal of Adverstising*, 18(2), pp. 207-231.

Kemp, S. and Dwyer, L. (2003), Mission statements of international airlines: a content analysis, *Tourism Management*, 24, pp. 635-653.

King, W.R. and Cleland, D.I. (1979), *Strategic Planning and Policy*, Van Nostrand Reinhold, New York, NY.

Klemm, M., Sanderson, S. and Luffman, G. (1991), Mission Statements: Selling Corporate Value to Employees, Long Range Planning, 24 (3), pp. 73-78.

Lipton, M. (1996), Demystifying the development of an organizational vision, *Sloan Management*, 37 (4), pp. 83-92.

Lucas, J.R. (1998), *Anatomy of a Vision Statement*, Management Review, February, pp. 22-27.

Neuendorf, K. (2002), *The Content Analysis Guidebook*, Thousand Oaks, CA: Sage.

Patton, M. (2002), *Qualitative Research and Evaluation Methods*, Thousand Oaks, CA: Sage.

Pearce, J.A. and David, F. (1987), Corporate mission statements: the bottom line, *Academy of Management Executive*, 1 (2), pp. 109-116.

Pearce, J.A. and Robinson, R.B. (1991), *Formulation, Implementation and Control of Competetive Strategy*, Richard D. Irwin, Boston, MA.

Piercy, N.F. and Morgan, N.A. (1994), Mission Analysis: an operational approach, *Journal of General Management*, 19 (3), pp. 1-19.

Singh, N., Zhao, H. and Hu, X. (2003), Cultural adaptation on the web: A study of American domestic and Chinese websites, *Journal of Global Information Management*, 11 (3), pp. 63-80.

Thompson, A.A. and Strckland, A.J. (1999), *Strategic Management Concepts and Cases,* McGraw-Hill, Boston, MA.

Thoms, P. and Greenberger, D. B. (1995), The relationship between leadership and time orientation, *Journal of Management Inquiry*, 4, pp. 272-292.

Thoms, P. and Greenberger, D. B. (1998), A Test of Vision Training and Potential Antecedents to Leaders' Visioning Ability, *Human Resource Develpment Quarterly*, 19 (1), pp. 3-19.

Vandijck, D., Desmidt, S. and Buelens, M. (2007), Relevance of mission statements in Flemish not-for-profit healthcare organizations, *Journal of Nursing Management*, 15, pp. 131-141.

Weber, R. (1990), *Basic Content Analysis*, 2nd Ed., Newbury Park, CA: Sage.

Woodraw, J. (2006), Institutional Mission: The Soul of Christian Higher Education, Christian Higher Education, 5, pp. 313-327**.**

# CLIMATE CHANGE AS AN IMPORTANT CONTEMPORARY STRATEGIC MANAGEMENT ISSUE

**Pınar Bal**
**Erol Eren**
**Beykent University, İstanbul**

## ABSTRACT

*This article aims to emphasize the emerging importance of climate change as an important strategic management issue for the contemporary business organization. As a background, first, climate change has been introduced as a new environmental threat of the last couple of decades. The global character of climate change is emphasized which puts it in a different place among other environmental problems that had difficulties in taking place within company strategies due to economic constraints. In this respect, the economic perspective of environmental policies have been underlined for the low rate of their integration to company policies and plans. On the other hand, to fight climate change, the requirement for the business world to make the transition to a low-carbon future is underlined. The importance of this transition on the survival and future competitiveness of the firm is emphasized. At this juncture, the Kyoto Protocol and its market-based mechanisms developed for the implementation of the global climate change regime are shortly described to be able to assess technically and economically feasible ways of implementing climate change policies for companies. The development of global carbon markets, Clean Development Mechanism, and Joint Implementation are analyzed as tools for cost reduction on the part of those companies which are utilizing climate change policies. As a concluding remark, the need of including climate change policies in both short-term and long-term plans of contemporary organizations have been emphasized. Hence, climate change is put forward as an important strategic management issue for the contemporary business organizations.*

*Keywords: Climate change, strategic management, Kyoto mechanisms, market-based mechanisms, transition to a low-carbon economy.*

## INTRODUCTION

Starting from the 1960s until the present, the world economy has started to witness a new environmental threat called as the climate change. Climate change, by its nature, is different from most of the other local environmental problems of the last couple of decades like certain pollution problems. Climate change is a global problem (Vogler , 2005) requiring global action.

For the business world, a new environmental problem means a new threat and a new economic burden on the firm. Although it is the social responsibility of the firms to take measures to help preserve the environment, many of them may not pay enough attention to these environmental topics due to their economic weight. However; when it comes to climate change, it is different. Until the present, international cooperation has been achieved to a certain extent and an international regime has been formulated to govern the issue (Paterson, 2001). Realistically, for the implementation of environmental measures and policies, the companies need to perceive an economic incentive resulting from such policies. The international regime which has been formulated over the last decade is a means of establishing climate change as a common global environmental problem as well as the structure of economic incentives available for those countries and companies who are willing to help the fight against climate change.

# CLIMATE CHANGE AS A NEW GLOBAL ENVIRONMENTAL THREAT

In the 1960s and 1970s, many environmental problems have come to the attention of the world community like ozone depletion, desertification, marine pollution, acid rain, destruction of tropical forests as well as climate change. Among these, climate change has achieved to establish the most effective international cooperation ever attained (Bodansky, 2001). The most outstanding feature of climate change is that it is a global problem common to all world states regardless of their developmental levels. Unfortunately, it is not an issue to be dealt by a particular region or a group of states.

Climate change occurs due to the changes of greenhouse gas concentrations in the atmosphere. The concentration levels of these gases have started to rise distinctively since the industrial revolution, due to the increasing use of fossil fuels for energy needs. However; the capacity of the atmosphere to absorb carbon dioxide; the major greenhouse gas emanating from the burning of fossil fuels, is limited. Despite this fact, on the other hand, atmosphere is one of the global commons which should be preserved for sustainable life on earth (Soroos, 2005:38).

The recent scientific findings present the basis that under the current consumption of fossil fuels and implementation of traditional production processes, future life on earth is threatened (IPCC, 2007). Based on these scientific findings, international action to fight climate change has been started to be arranged. Since climate change has been perceived to be the outcome of the rapid industrialization process of the Western world emanating from the excess amounts of fossil fuel burning, the responsibility to fight it has been given to the Western world at the beginning.

However; it was known from the beginning that without the contribution of the developing world, it would not be possible to stabilize the greenhouse gas concentrations in the atmosphere at tolerable levels (Heller & Shukla, 2003). The developing nations were supporting the argument that since the developed nations have been able to achieve their industrialization by burning as much fossil fuels as they wanted to, the developing nations should be able to go through the same steps as well to continue with their industrialization. Unfortunately, according to scientific information, this cannot be the case anymore, since unified action on a global scale is required for a successful outcome (Grubb, 2004). The logic behind both the United Nations Framework Convention on Climate Change (UNFCCC) signed in 1991 and the Kyoto Protocol signed in 1997 has been the same; to create a global regime with global participation to fight climate change. The basis and the aim of this fight would be to transform the high carbon world economy to a low carbon one.

# CLIMATE CHANGE and the BUSINESS WORLD

The fight against climate change requires change in organizations. In other words, as a result of the new policies required to fight climate change, the environment surrounding the organizations changes. As a matter of fact, organizations do and can adapt to change to be able to continue their survival.

**Adaptation in a changing environment**

There are a variety of theories of organizational adaptation. According to the theory of population ecology; once an organization has been established in a particular environment, it will not be able to adapt to changing conditions. Under these circumstances, it is replaced by other newer organizations which are more suited to the new environment. The institution theory, on the other hand, supports the view that organizations can adapt to changes in the environment by imitating others. According to the strategic choice perspective, which is the dominant one in strategic management, organizations can adapt to changes in the environment as well as having the power and opportunity to reshape their environment (Wheelen & Hunger, 2004: 8). The argument which governs the strategic choice perspective that adaptation is a dynamic process seems to be in parallel with the view of organizational learning theory. Organizational learning theory is described by Wheelen & Hunger as a view of "organizations that adjust defensively to a changing environment and use knowledge offensively to improve the fit between the organization and the environment" (2004:8).

**Survival in a changing environment and organizational learning**

To be able to survive, on the other hand, a company should have strategic flexibility that is the ability to shift from one dominant strategy to another (Wheelen & Hunger, 2004: 8). The long term commitment to the development and nurturing of critical resources is necessary for strategic flexibility. Another necessity for strategic flexibility is that the organization should become a learning one. Wheelen & Hunger describe a learning organization as "skilled at creating, acquiring and transferring knowledge and at modifying its behavior to reflect new knowledge and insights" (2004:8). In a changing environment, organizational learning becomes an important component of competitiveness.

During the environmental scanning process of a learning organization, the push for the transition of the world economy to a low carbon one can be considered as a strategic factor; as an external factor which will determine the future survival of the corporation. As a matter of fact, this can both be a threat and an opportunity for a firm. The companies which are not open to change will perceive this as a threat to its long term survival, while a learning organization will try to see it as an opportunity and even a strength for the future.

The necessary steps to achieve transition to a low carbon economy would require certain technological investments at the first glance. This can be handled as part of a corporate/business or functional strategy to help the survival of the company as well as to provide it with a competitive advantage. Presently, many companies have started to treat climate change as an important area of social responsibility. Dess et. al (2004:16) define social responsibility as the "expectation that businesses or individuals will strive to improve the overall welfare of society". Just like norms and values change over time, the areas requiring social responsibility also change. From the 1990s onwards, the quality of the environment had started to be taken serious among firms as part of their social responsibility. For companies, the usual way of showing this responsibility has most of the time been in terms of engaging in recycling and reducing waste. However, concerning climate change, transition of the production systems is necessary to reduce the carbon emissions together with other specific measures.

**Transition to a Low Carbon Economy –The Third Industrial Revolution**

A low carbon economy is a concept which has developed over the last decade to refer to an economy that has a minimal output of greenhouse gas emissions into the atmosphere. In a low carbon economy:

- All wastes should be minimized through reduction, reusing or recycling techniques and systems
- Energy should be produced using low carbon energy sources, fuels and sequestration
- All resources, especially energy should be used very efficiently
- There should be high awareness and compliance with environmental and social responsibility initiatives on the part of the industry, commerce and the individual (Low Carbon Economy, 2009a).

The first industrial revolution that the world witnessed had taken place at the end of the 18$^{th}$ century with the invention of the steam engine which introduced new production systems that changed the ways of doing business. As a result of the developments in information technology, there came the second industrial revolution towards the end of the 20$^{th}$ century. Only two decades ago, no one could have guessed the effects of such revolution on societies and the business world. Within such a short period of time, presently, it is not possible to think of life without modern information technology, especially the business world. Computers, computer programs, internet, Google and Yahoo have turned out to be the dispensable part of contemporary daily life of people as well as businesses. It is, now, hard to think of companies operating without computerized systems. Unfortunately, those companies which have resisted change, have not been able to survive and been replaced by newer ones.

Management science has gained importance with the industrial revolution of the 18$^{th}$ century. The technological improvements and new issues in world stage have led to the development of management science over the years. The new findings of the 18$^{th}$ century have led to important changes in social and business life at those years. Presently, the strategic management of the development and transfer of technologies for adaptation to and mitigation of climate change have become an important issue. The expected costs related to climate change in the coming years are the expenses related to the adoption of technologies and building/operating projects/plans/schemes…

According to scientific findings (IPCC, 2007), the consequences of failure in this transition would be economically and physically catastrophic for mankind. Therefore, presently, the world is at the start of a third industrial revolution centered around the transition to a low carbon economy. This revolution, just like the previous two revolutions, puts the traditional systems at a disadvantage by decreasing their competitive advantage vis a vis the new techniques, threatens their survival, requires new investments but in return offers great economic opportunities and new business areas. Those companies who have already been involved in this transition, have started to see the benefits such as new markets and consumers, improved triple bottom line (economic, social and environmental performance) and reduced bills and risks (Low Carbon Economy, 2009a).

Presently, it is possible to say that the transition to a low carbon economy has become a priority for a sustainable world. Knowing this, transition to a low carbon economy has become the new trend in business life in many industrialized countries (Brewer, 2007). Preparations have started in this direction a few years ago. In a Conference held in Brussels in November 2007, the Vice President of the European Commission as well as the EU Commissioner for Enterprise and Industry; Günter Verheugen has clearly explained the importance given by the EU to the transition to a low carbon economy:

> "European leaders have made clear through the 2020 commitment that Europe intends to lead the move to a global low carbon economy. This brings with it a set of unique opportunities and challenges. The opportunity is to be technology leader and therefore technology supplier in the future. The challenge is that additional pressure is placed on European industry. However, if managed well the benefits can outweigh the costs. The benefit of this first mover advantage stems from the fact that the issues faced by Europe are not dissimilar to other regions of the world; if Europe is setting the pace, industry in other parts of the world will also have to make similar adaptations" (European Commission, 2007).

> "An overarching message is that there is no solution without the engagement of business. It is the business community that will need to innovate and develop the low carbon products of future and redirect their investments to more sustainable ventures …….while Europe should lead on climate change and low carbon and energy efficiency technologies, it is also crucial to engage other countries and work towards global action. All channels need to be used" (European Commission, 2007).

In the United Kingdom Low Carbon Economy Summit held in March 2009, where the UK Government formally launched the "Low Carbon Industrial Strategy: Vision", Prime Minister Gordon Brown explained the priority that the UK gives to low carbon economy: "We must be the first of the low carbon powers" (Low Carbon Economy, 2009b).

In parallel with these plans, the transition of the global business environment as well as the economy is inescapable in the years to come. This transition will require serious planning and management activities on the part of the business world for sustainability and survival.

## CLIMATE CHANGE AS A STRATEGIC MANAGEMENT ISSUE

If strategic management is defined as "consisting of the analysis, decisions and actions an organization undertakes to create and sustain competitive advantage" (Dess et. al. 2004: 31), then, presently, climate change has become an important strategic management issue for businesses all over the world. Climate change requires to think and act globally.

In the present business world, creating an environmentally aware organization has gained importance. Through successful environmental scanning, the company might become open to critical new trends and events before these changes have become common to competitors. By being proactive, the company would have the chance of eliminating the outcome of being reactive.

According to the CEO of BP Amoco; Sir John Browne, his company was experiencing an environmental change:

> "The next element of the change we've experienced is the growth in demand, and the changing nature of that demand. The world uses 8 million more barrels of oil and 30 billion more cubic feet of natural gas every day than it did in the spring of 1990. The growth of natural gas in particular has been and continues to be spectacular, and I believe that change can legitimately be seen as part of a wider, longer-term shift to lighter, cleaner, less carbon-intensive fuels." (Dess *et.al.*, 2004: 40).

The companies of the energy industry, dealing with fossil-fuel extraction, have started to prepare themselves for the transition to a low carbon future in 1990s, although they have acted against the scientific community during the 1980s (Elliot, 1998: 125). Although many corporations have aimed to work in an effort to weaken various regimes and corporate and multinational companies' interests have exercised influence over environmental policy making over the last couple of decades, the reality and the inevitability of the climate change issue have forced many corporations and multinational corporations of the present day to take necessary measures to achieve the transition to a low carbon economy. This should be seen as a very important start.

Although voluntary initiatives and self regulation are important for companies on their way towards a low carbon future, the satisfaction of economic interests and the establishment of free market mechanisms make a very effective contribution to sustainable development (Elliot, 1998: 128). These mechanisms encourage businesses to adopt sustainable policies. Most of the time, multinational corporations, through implementing self regulation and voluntary action, create the new standards of business or the codes of conduct they wish to have. They also form strategic alliances to settle the environmental framework which they long to see at the global level (Elliot, 1998: 128).

> "If sustainable development is to be achieved, environmental concerns must…….. be factored to the very center of economic decision making." (Elliot, 1998: 244)

Strategy is commonly defined as a plan to achieve a purpose. Strategy results from careful analysis. Strategies change according to environmental developments.

Strategic planning is a way to identify and move toward desired future goals. During strategic planning, SWOT analysis helps organizations to evaluate the environmental factors and the internal situation of their companies concerning an issue. Strengths and weaknesses are attributes related to internal capability. Opportunities and threats are related to the effects of environmental factors on the firm (Thompson & Strickland, 1995). In this respect, strategically; climate change is a threat and low carbon production can be an opportunity and even a strength for the future of the firms. Early entrants will have (first mover) advantage.

SWOT analysis can help to turn weaknesses and threats into opportunities and ultimately into strengths. Climate change should be evaluated within this perspective. Even though climate change is a common threat of the present, the aim should be to transform this threat to an opportunity and then to a strength for a firm. This is already the social responsibility of companies, however, this transition is also required for the survival of companies in the years to come.

Presently, climate change and the related requirements of low carbon investments has turned out to be an important external factor for companies' long term survival in the market. Especially, companies are affected from the technological, environmental and legal aspects of climate change. Technologically, the fight against climate change requires the transition to low carbon production systems. These systems require different technological investments and adjustments. On the other hand, the awareness of the world community towards climate change is increasing day by day. The importance given to the fight against climate change is increasing rapidly, too. The European Union and some of the States of the United States have already committed themselves to specific targets to be reached by specific dates. Under the Kyoto Protocol, the countries of the industrialized world are already working to achieve their targets for the first commitment period which started as of January 2008 and to be concluded in 2012. Under these circumstances, a change in the legal environment is highly possible in the near future. As the regime gets more stable, to be able to achieve compliance with the new regime, sanctions are expected to be a part of it (Eren, 2007: 135).

As for the second commitment period to start by the end of 2012, negotiations between the countries continue at the global level under the United Nations Framework Convention on Climate Change and the Kyoto Protocol. All these developments signal the necessity of a structural change for companies. In the light of these developments, it is highly possible to say that the coming years will witness the demise of the traditional ways of production and the rise of new technology in line with low carbon production.

**Climate Change Policies of the EU**

The EU is working very serious on the climate change issue. With the adoption of the latest energy-climate change package, the EU has shown its dedication to the climate change issue as well as its leadership. In January 2007, the EU has announced its important decision and dedication of achieving an industrial revolution within the EU by transforming its economy to a low-carbon one (EurActive, 2007). In parallel with this goal, the EU has announced its decision to unilaterally reduce its GHG emissions by 20% until 2020. The EU further proposed to increase this commitment to 30% if the international community joins in this effort.

It seems that this unilateral reduction would prove EU's commitment to climate change and represent an impressive edge to persuade other countries to join EU's efforts. On the competitive side, those companies who are investing in new opportunities and innovations as the result of climate change will be making profits. The growing public awareness concerning the possible effects of climate change will reward those companies which are producing climate-friendly products. According to the EU Commissioner Dimas responsible for energy policy, vis a vis those countries who still do not join the efforts concerning the period after 2012, then the EU will already be prepared for the low-carbon future and at that time this will be a competitive advantage for the European companies (EurActive, 2007).

Under those circumstances, the EU may attempt to impose countervailing duties against the imports of those countries who have not participated in common action for climate protection to be able to compensate for the lower costs of those companies.

Climate change has also been announced to be a national priority by the US President Barack Obama. The US Secretary of State, Hillary Clinton has also emphasized the importance given to climate change by her Administration:

> "We are sending an unequivocal message that the US will be energetic, focused, strategic and serious about addressing global climate change and the corollary issue of clean energy" (US Department of State, 2009).

Although the US has still not ratified the Kyoto Protocol until the present, the new Administration has made it clear that there will be a dramatic change in the US position towards climate change. This should be taken as another sign of a new business environment in the years to come that is supported by the US as well.

Both in the EU and in the US, some states have already come up with the idea of applying protectionist and discriminatory measures against those companies who are producing with old technologies with high carbon emissions. If, towards the end of 2009, the world countries together with the US are expected to conclude their negotiations concerning the climate change regime of the post-2012 period, which will be the second commitment period of the Kyoto Protocol, then the legal environment surrounding the business firms is expected to be much more restrictive than the present day. Within a few years, those companies who have not achieved to go through the necessary transition to a low carbon production system, might face serious legal as well as market entry problems. These companies which miss to achieve this technological transition might fall behind the market, lose its customer base as a consequence of increasing customer awareness, deal with legal problems, hence, would be at a disadvantage vis a vis those companies who have already seen climate change as an external threat and taken necessary measures against this threat in a strategic manner; in other words; manipulated the threat to an opportunity and then to a strength for the company.

From the consumers' perspective, as a result of increasing awareness on climate change, consumers in developed countries have increasingly began to search for those products which are being produced in a climate friendly manner. In many industrialized countries, consumers are willing to pay a little more just to make sure that they are not enhancing the climate problem. Therefore, as a result of further negotiations between the countries at the global level; from the customers' perspective, climate change has began to play an important role and this is expected to continue with an increasing trend. If businesses are sensitive to satisfying the expectations of their customers, from this perspective, the climate change issue is highly worth of attention for companies.

# THE GLOBAL CLIMATE CHANGE REGIME and ITS MECHANISMS

The Kyoto Protocol tries to achieve a balance between technically and economically feasible ways to reduce the anthropogenic emissions as well as to reduce the concentration of carbon dioxide and other GHGs in the atmosphere (Kyoto Protocol, 1997). Its focus is to promote energy efficiency, switching to cleaner energy sources and the technological innovation needed for attaining these goals (Cutajar, 2004: 66).

## Market based mechanisms of the climate change regime

The present climate change regime presents companies certain mechanisms through which they can merge environmental responsibility with economic rationality (Dessler & Parson, 2006). In other words, the present regime offers companies ways of achieving emissions reductions without putting them at a financial disadvantage in the market (Yamin & Dephledge, 2004). At the present, there are three mechanisms. The first one is the Clean Development Mechanism (CDM) which concerns the low carbon investments of industrialized countries in the developing countries. The CDM allows for the transfer of environmental friendly technologies to the developing countries through the investments of the developed world. Through the CDM projects, the developed countries can implement sustainable development project activities to reduce emissions in the developed countries. The major aim of the CDM is to provide incentives to developed countries and their firms to invest in climate-friendly projects in developing countries since they generate emission reduction credits that can be utilized by the developed countries to reach their emission reduction targets. From the perspective of the developing countries, the CDM intends to help them move on to more "sustainable and lower emitting paths of economic development" in which case the costs are carried by the developed countries themselves. By this way, the companies in the developing countries get the chance of continuing their development in a sustainable way. Hence, the ultimate objective of the Convention is being met. The CDM, being an alternative for achieving the cost effectiveness of climate change policies, plays an important role for supporting the willingness of the countries to meet their emission targets (Dessai et. al., 2003).

The other Kyoto mechanism is Joint Implementation (JI). Its logic is the same with CDM, however, JI can be utilized among industrialized countries. Until the present, JI projects have been implemented in the Eastern and Central European countries whose economies were still in transition where many attractive projects were available.

Emissions trading enables industrialized countries (Annex I Parties under the UNFCCC) to trade their emissions in order to reach their emission reduction targets under the Kyoto Protocol. Through emissions trading, the industrialized countries which have already met their targets and still have assigned units which are not used can transfer these units to the other industrialized countries that have already used up their assigned units but could not have met their reduction targets (UNFCCC, 2005: 32-33). In the global emissions markets, industrial firms are allowed to buy the rights to pollute (to emit carbon dioxide) from other firms which have already reduced their emissions below their allowable levels. It is also possible to purchase these pollution rights from developing societies which have still not yet reached their allowable emissions thresholds. The pollution markets create rewards for those innovative firms through balancing the costs of reducing pollution by selling unused emissions credits to other firms that need them. On the other hand, the firms who need them then are able to delay emissions reductions and has gained the time to make necessary investments which would enable reductions (Lutzenhiser, 2001: 513).

Presently, the EU has an operating carbon market called the EU Emissions Trading System (ETS). There are also other carbon markets in some of the US States as well as voluntary carbon markets which are operating outside the scope of the Kyoto Protocol. The global carbon markets keep growing rapidly and offer attractive incentives to those companies on their transition to a low carbon economy.

# CONCLUSION

Climate change is the most important environmental threat of the present day. It is a global threat requiring global action to fight against. Presently, the world states have accepted this threat as the major challenge of future sustainability on earth. In this respect, a global climate change regime has already been established to fight climate change for which negotiations continue for wider and deeper action to be finalized at the end of

2009. Many countries led by the EU have started to take measures to transform their economies to a low carbon future which forms the basis of the fight against climate change. As a matter of fact, this transition changes the traditional environment which surrounded the business world. Both to support a sustainable earth as well as to keep the survival of business enterprises, adaptation of the business world to the low carbon economy is of utmost importance. Taking into consideration the global engagement to fight climate change, the benefits of shifting to a low carbon economy and products will be much more than the disadvantage that a few sectors will face. Under these circumstances, it has become necessary for the business world to make preparations to adapt to the new environment. In this respect, the fight against climate change which requires the transition to a low carbon economy should be taken as a new strategic management issue for the contemporary business organizations. Through strategic management, it can be possible for companies to manipulate this climate change threat to an opportunity and even to a strength in the coming years. The present global climate change regime offers the economic incentives necessary for companies to pay attention to this very important global issue. Unfortunately, they have no chance of survival other than adaptation.

In the post-2012 arrangements of the global climate change regime, binding carbon reduction commitments for many countries are expected to be in force. To make this challenge manageable, companies should start getting prepared. Otherwise, the time period left for preparations and adaptation to the new environment might be too little and require much more investments with higher costs. The companies of the present are facing the dilemma of either investing today for the future survival of the firm or not investing under the business as usual scenario and taking the risk of higher bills and diminishing competitiveness in the coming years.

## REFERENCES

Bodansky, Daniel (2001). "International Law and Regime Design". in Urs Luterbacher & Detlef F. Sprinz *(*Eds.), *International Relations and Global Climate Change,* The MIT Press, Massachusetts:201-219.

Brewer, Thomas L. (2007). "Technology, Emissions Trading and International Trade: New Issues and Paradigms for the Expanding Climate Change Agenda" Paper presented at the *Annual Meeting of the Swedish Network of European Economists (SNEE).* 25 May, 2007, Mölle, Sweden.

Cutajar, Michael Zammit (2004). "Reflections on the Kyoto Protocol-Looking Back to See Ahead". I*nternational Review for Environmental Studies* 5, No.1: 61-70.

Dess, Gregory G., Lumpkin, G.T. & Eisner, Alan B. (2004). "*Strategic Management*".McGraw Hill, NY.

Dessai, Suraje & Nuno S. Lacasta & Katharine Vincent (2003). "International Political History of the Kyoto Protocol: From the Hague to Marrakesh and Beyond". *International Review for Environmental Studies* 4, No.2:183-205.

Dessler, Andrew E. & Edward A. Parson. (2006*). The Science and Politics of Global Climate Change*. Cambridge University Press, Cambridge.

Elliott, Lorraine (1998). "*The Global Politics of the Environment*". Macmillan Press Ltd, London.

Eren, Erol (2007). "*Stratejik Yönetim ve İşletme Politikası*". Beta Basım A.Ş., İstanbul.

*EurActive* (2007). "EU Energy Summit: A new Start for Europe".

**http://www.euractiv.com/en/energy/eu-energy-summit-new-start-europe/article-162432?_print**

accessed on 13.03 2007.

European Commission (2007). "Low Carbon Economy". *Conference Report of the High Level Group on Competitiveness, Energy and the Environment.* Brussels, 27 November 2007.

Grubb, Michael (2004). "Kyoto and the Future of International Climate Change Responses: From Here to Where?" *International Review for Environmental Studies* 5, No.1: 15-38.

Heller, Thomas C. & P. R. Shukla (2003). "Development and Climate: Engaging the Global Effort". in *Beyond Kyoto: Advancing the Global Effort against Climate change.* Pew Center on Global Climate Change, December, 2003: 111-141.

Kyoto Protocol (1997). Kyoto Protocol to the United Nations Framework Convention on Climate Change. 11 December, 1997, Kyoto, Japan. **http://unfccc.int/resource/docs/convkp/kpeng.pdf**

IPCC, (2007). *Climate Change 2007: The Physical Science Basis. Summary for Policy Makers.* Contribution of Working Group I to the Fourth Assessment report of the IPCC, February, 2007.

**www.ipcc.ch/SPM2feb07.pdf** accessed on 12.09.2007.

Low Carbon Economy Website (2009a). *About a Low Carbon Economy*. www.lowcarboneconomy.com/LCE/AboutALowCarbonEconomy accessed on January 5th, 2009.

Low Carbon Economy Website (2009b). Report on the UK 'Low Carbon Industrial Strategy: Vision'

**http://www.lowcarboneconomy.com/_low_carbon_blog#blog4784**

Lutzenhiser, Loren (2001). "The Contours of US Climate Non-Policy". *Society and Natural Resources*, 14: 511-523.

Paterson, Matthew (2000). *Understanding Global Environmental Politics: Domination, Accumulation, Resistance*. MacMillan Press Ltd, Great Britain.

Soroos, Marvin S. (2005). "Garret Hardin and Tragedies of Global Commons" in Peter Dauvergne (ed.) *Handbook of Global Environmental Politics*, Edward Elgar, Cheltenham: 35- 51.

Thompson, A. & Strickland, A.J. (1995). *Crafting and Implementing Strategy*. Richard D. Irwin Inc.

Tosun, Kemal (1990). "*Yönetim ve İşletme Politikası*". İşletme Enstitüsü Yayını, No.125. İstanbul.

UNFCCC (2005). *Caring for Climate Change. A guide to the Climate Convention and the Kyoto Protocol* (revised 2005 edition). Climate Change Secretariat (UNFCCC) Bonn, Germany.

US Department of State (2009). "Obama makes climate change a national priority". *America.gov.* 27 January2009.

**http://www.america.gov/st/env-english/2009/January/20090127161856lcnirellep9.743899e-02.html**

Vogler, John (2005). "Studying the Global Commons: Governance Without politics?" in Peter Dauvergne (ed) *Handbook of Global environmental Politics*, Edward Elgar, Cheltenham: 51-64.

Wheelen, Thomas L. & Hunger, David J. (2004). *"Strategic Management and Business Policy"*. Pearson Education Inc, New Jersey.

Yamin, Farhana & Joanna Depledge (2004). *The International Climate Change Regime: A Guide to Rules, Institutions and Procedures.* Cambridge University Press, Cambridge.

# STRATEGY-MAKING APPROACHES FOR A CHANGING ENVIRONMENT

**Rachel Maritz**
**University of Pretoria (RSA)**

**Marius Pretorius**
**University of Pretoria (RSA)**

## ABSTRACT

*The paper highlights the results from a study that describes strategy-making approaches in South African organisations. A continuum of strategy-making approaches is crystallised from literature, ranging from rational planning on one end to an emergent approach on the other end. These approaches are described and applied to investigate the prominence of these strategy-making approaches in practice. This study made use of mixed method research, enabling quantitative data (questionnaires from organisations) to be corroborated with qualitative data (interviews with CEO's). Results were also quantified and a spread of data analysis techniques applied to provide the most reliable and valid results and conclusions.*

## 1. INTRODUCTION

Changing business environments require changes in how organisations fundamentally conduct business. One area of management which has always been characterised by controversy and diverse approaches based on seemingly exclusive fundamental theories, is the area of strategy.

Nag, Hambrick and Chen (2007:952) ponder the apparent substantial success of strategic management both in practice and as research field, despite the fact that some strategic management scholars lament the field's disparate, ambiguous nature. Their conclusion (based on distinctive strategy lexicon in 447 strategic management articles appearing in major management journals) is that there is general consensus on the essence of strategy. They suggest the following definition as portraying the essence of strategy (Nag *et al.* 2007:944):

> The field of strategic management deals with the major *intended and emergent initiatives* taken by *general managers* on behalf of owners, involving utilization of resources, to *enhance performance of firms in their external environments* [own italics].

In this paper the essence of strategy remains unquestioned. However, a theoretical debate on the process of strategy-making is relayed and the empirical study that follows focusses on what really happens in practice. The above definition is especially important to this study for the reference to "intended and emergent" initiatives as well as the reference to performance and the influence of the environment on strategy-making. Since strategy theory should be in constant conversation with practice to stay relevant and significant, the authors are of the opinion that scholarly enquiry about strategy should pause at the reality of strategy in practice. The belief is that strategy should reflect demands of the organisational environments and as such be shaped by business realities. Strategy for organisations in a fast changing and challenging world should be dynamic and as the study will show, does not necessarily look like theories statically propose.

This paper will place the specific research discussed here within the context of strategy research in general and outline the research focus, problem and objectives. The construct of strategy-making will be crystallised from academic literature based on research and academic conversation in this area of strategy. The research methodology, research findings, conclusions and the particular contribution of this research will be presented.

# 2. RESEARCH FOCUS

The following section offers a brief overview of strategy research in general and the focus of the research discussed in this paper specifically. The research problem and objectives will subsequently be outlined.

## 2.1 Strategy Research In General And The Focus Of This Study

The research efforts of the academic arm of strategy management can be roughly divided into a **content** and **process** tradition (Hilse & Nicolai; 2004:372). Content research concerns itself with the content of strategic decisions, especially with regard to the connection between performance and market position, resources provision, or specific constellations of company attributes and environmental conditions. Process research or strategy process theory, on the other hand, examines decision-making processes as well as their relation to the organisation and deals with planning methods, questions of implementation and so on (Lechner & Mueller-Stewens, 2002). Strategic understanding of process research can be very concisely described as a sequence of events (Hilse & Nicolai, 2004:373). Content is concerned with the type of strategic decision, while process focuses on its formulation and implementation (Cyert & March, 1963; Andrews, 1981). Pettigrew (1992) perceives that process research and strategy are essentially concerned with choice processes (strategic decision-making) and implementation processes (strategic change). Van de Ven (1992), in contrast, argues that strategy process research is diverse and cannot be contained within any single paradigm.

Szulanski, Porac and Doz (2005:xiii) attribute the "enduring scholarly interest in the process of strategy-making" to "the abiding assumption that some ways of strategizing are more efficacious that others, and thus lead to higher firm performance in the long run; higher than luck alone would bring". They state that expressions of interest in and endorsements of the strategy process are abundant in the academic literature. It is therefore not surprising that "the quest to uncover stable principles of good strategy making has attracted much support and interest over the years" (Szulanski *et al,* 2005: xiii). Regnér (2005:189) agrees with this when he states that strategy content research has presented a systematic analysis on the basis of competitive advantage, and strategy process research has provided careful in-depth descriptions and examinations of strategy making. He asserts that strategy process views have provided rich and systematic descriptions showing that strategy-making involves a variety of contextual influences and actors in addition to analytical exercises and leadership by managers at the centre. The apparent interest in process-related topics has seen a resurgence that had transcended national boundaries and are occurring all around the world (Szulanski *et al.* 2005:xiv).

This paper captures the essence of a research study conducted in South Africa involving about 20 organisations and their CEOs to explore the nature of strategy creation. Contentious issues up for debate in the study centre on the process of creating strategies. Two distinct and clearly opposite views can be discerned in the literature. A view associated with Henry Mintzberg, arguably one of the most trenchant critics of planning (Heracleous 1998:481), is that planning cannot produce strategies because it is a programmatic, formalised and analytical process; it is rather what happens after strategies are decided, discovered or simply emerge. The research presented herein will highlight some of the opposing views on strategy-making, where a continuum crystallises with on the one extreme a more formal process approach to strategy-making and on the other an approach where strategy is the result of an adaptive process and strategies evolve as circumstances warrant and certain organisational patterns become clear. The distinction between deliberately planned and emerging strategies is critical for the advancement of a definition of strategy in this study.

The study seeks to uncover the true nature of strategy in South African organisations. The emphasis throughout the study is on the creation (formation) of strategy, whether separated by planning theorists from implementation or believed to be inseparably part of the implementation. Some authors argue that a sequential process which separates formulation and implementation cannot be justified, since strategy formulation and implementation cannot always be separated – especially within the explanation of emergent strategies, which are held to be implemented on the go and not according to a previously formulated strategy (Mintzberg & Waters, 1985; 1990; 1994; 1995; Heracleous, 1998; Inkpen & Choudhury, 1995).

The term strategy-'making' is therefore used throughout (instead of alternatives such as 'creation' or 'development'). "Strategy formation" and "strategy-making" are used interchangeably, since the term "strategy formation" is used widely in academic literature. The term 'making' (or 'formation') implies not only *creating* a strategy but could also mean *operationalising* it or *putting it into practice*. The latter part of the definition is important because the nature of emergent strategies is precisely that they are not necessarily deliberately planned (or created for that matter) but *come into being* somewhere along the way.

## 2.2 Research Problem

It is evident from literature that there is considerable lack of congruence on the process of strategy-making. The ardent literature debate on the nature of strategy-making does not always provide clarity with regard to the face of strategy in organisations and specifically South African organisations.

The primary objective of the study is to:

- Investigate and describe the mode of strategy-making followed in South African organisations.

The following hypotheses were formulated from the research objectives:

| | |
|---|---|
| **Null hypothesis 1(H1o):** | The actual mode of strategy-making in South African organisations cannot be clearly identified |
| **Alternative hypothesis 1 (H1a):** | The actual mode of strategy-making in South African organisations can be clearly identified |

## 3. The Academic Debate On Strategy-Making

Some salient issues emanating from a literature research are discussed below to sketch the context for the research findings discussed in this paper.

## 3.1 Debating The Process Of Strategy-Making

Strategy has come a long way since the emphasis fell on comprehensive, systematic, rational planning. In the past decades strategy has appeared in many guises and displayed a seemingly disparate and ambiguous nature. McGee, Thomas and Wilson (2005: *preface*) point out that many contemporary authors in strategy have developed a rather dismissive approach to the work that has preceded their own perspectives. In their opinion the field of strategy has been strongly characterised by the almost total substitution of one frame of reference for another, as time has progressed. They cite as an example the models of rational planning that have been "dismissed and ignored" by later writers, who have emphasised a more emergent or "politically shaped view of strategy". These paradigmatic shifts cannot be ignored, yet, state McGee *et al* (2005: *preface)* these shifts are in practice difficult to spot, characterised as much by latest fads as by the fact that many authors have published books simply listing the various perspectives that can be taken toward strategy. McGee *et al* (2005:*preface*) claim that of all the concepts in management, strategy is the one that attracts the most attention and generates the most controversy. Almost everyone agrees that it is important. Almost no one agrees on what it is.

Mintzberg, Ahlstrand and Lampel (1998:8) share these negative sentiments on strategy theory when they assert that there is a "terrible bias" in today's management literature toward the current, the latest, the 'hottest'. They claim (Mintzberg *et al,* 1998:8) that this does a disservice
to all those "wonderful old writers", and especially to the readers who are offered the trivial new instead of the significant old. We believe that time works on the literature and practice of strategic management much like it works on wine in barrels: it reveals what is excellent.

According to Nag *et al* (2007:935), strategic management represents a case of an academic field whose consensual meaning might be expected to be fragile, even lacking, and asking strategic management scholars to define the field might elicit an array of responses. However, despite the seeming fragmentation, Nag *et al* (2007:936) believe that the field still has a collective identity and distinctiveness due to a strong implicit consensus about the essence of the field, even though there may be ambiguity about its formal definition.

Why the emphasis on the creation of strategy, when "failure is almost always attributed to implementation" (Mintzberg , Ahlstrand and Lampel, 2005:32)? The answer lies in the question of whether strategy formation and implementation can really be separated. The debate as it unfolds centres around the being of strategy: why strategies when finally implemented (so-called realised strategies) sometimes differ from intended strategies. These strategies that realise but were not intended, are referred to as emergent strategies. Hilse and Nicolai (2004:375) explain the two extremes as follows: "In extreme cases, strategies occur through a 'grass roots model' where strategic initiatives that have been distributed within the organisation and have nothing in common with the intended strategy 'grow rampant'. The other extreme would be a comprehensive, deliberate strategy where the intended strategy is completely realized".

The debate is also about how strategies come (and should come) to life in organisations, with proponents on various sides prescribing and describing issues around strategy with conviction and passion.

## 3.2 Divergent approaches to strategy-making

An account of debated issues concerning strategy-making process which typically focus on opposing views is given below. The diagram presented (figure 3.1) summarises the main elements. This diagram is presented as the point of departure for the ensuing discussion on process elements, but initially crystallised only after a comprehensive literature survey.

### 3.2.1 Crystallising A Continuum Of Strategy-Making Approaches From Literature

The definition derived from academic consensus stated above in the introduction section of this paper (Nag *et al.* 2007:944) highlights a distinction between deliberately planned and emergent strategies. The debate on the process of strategy-making unfolds in opposing and often extreme views. Literature does not always make a clear distinction between the views on either end of the continuum and rather describe approaches associated with each of these views. The two extreme views are associated with the purely rational, deliberate approach to strategy-making on the one end and the emergent, adaptive approach to strategy-making on the other end.

The following figure 3.1 illustrates the extreme views. This figure is explained in more detail below.

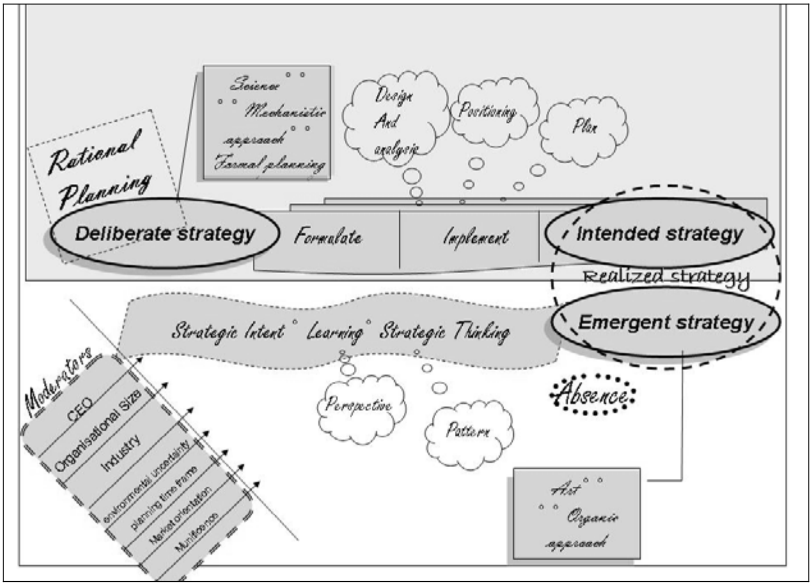



***Figure 3.1 Two extreme approaches to strategy-making (rational planning versus emergent strategy)(Source: Own compilation)***

Two approaches are positioned as alternative approaches. These are descriptive of opposing views on strategy-making but are not mutually exclusive. Harrington, Lemak, Reed and Kendall (2004:17–19) propose that the deliberate view and emergent view discussed below should be viewed as *ends of a continuum with multiple elements.* This is in line with thinking expressed by Mintzberg and McHugh (1985) and Mintzberg and Waters (1985). The deliberate end of the continuum refers to a more rational and comprehensive approach, while the emergent view, on the other end, refers to a more incremental and trial-and-error type of approach (Harrington *et al,* 2004:17). Organisations tend to follow a specific approach or a combination of the two (this will be substantiated by a discussion of the findings later in the paper).

The choice of approach is moderated by certain factors (named "moderators" in the figure). In other words aspects such as the prominence of the CEO, the organisational size, industry and organisational life cycle influence the approach an organisation follows to form its strategy (Parnell & Lester 2003:294; Harrington *et al* 2004:16; Baum & Wally, 2003).

The result of the strategy-making approach is in the form of three broad outcomes

1. **Intended strategies**, which are planned but not necessarily realised;
2. **Deliberate or realised strategies**, which are intended strategies that have been realised; and
3. **Emergent strategies**, where the pattern that was realised was not expressly intended (Mintzberg *et al,* 1998:9).

### *The rational planning/ deliberate approach to strategy-making*

The approach to strategy-making depicted in the shaded area above the line in figure 3.1 is the rational planning or deliberate approach. This approach is associated with a formal process of formulating and implementing strategies. A brief discussion on the elements that can be discerned from figure 3.1 follows:

It is sometimes also labelled as the **science approach** (as opposed to strategy as an art) to strategy-making. Followers of the science perspective see the business environment as largely objective, analysable and predictable to a great extent. As such, strategic managers should follow a systematic process of environmental, competitive and internal analysis and build the organisation's strategy on this foundation" (Parnell & Lester, 2003:292).

The rational planning approach is also associated with the **mechanistic approach**. The development of strategy can be categorised in two broad 'progressions' (Farjoun; 2002:561), namely the mechanistic and organic perspectives. These two broad 'progressions' of the development of strategy are distinguished more by epistemological differences than by chronological order. These categories are viewed as describing on a continuum rather than a dichotomy of pure types. The first development, referred to as the mechanistic view, consisted of several interdisciplinary-based and stand-alone theories, mainly SCP (Structure-Conduct-Performance), SSP (Strategy-Structure-Performance) and RBV (Resource Based View). These theories were used to explain variations in strategy and performance. Strategy itself has been mainly viewed as a *posture and a plan*. The design model and the SWOT (strengths, weaknesses, opportunities, and threats) model have been used as the main models of strategic management and strategic choice respectively.

The rational planning approach is furthermore associated with the so-called design school of strategy. At its simplest, the **design** school proposes a model of strategy-making that seeks to attain a match, or 'fit', between internal capabilities and external possibilities (Mintzberg *et al,* 1998:24). Economic strategy is seen as the match between qualifications and opportunity that **positions** a firm in its environment (Christensen, Andrews, Bower, Hamermesh & Porter, 1982:164). The design school focuses on *a point in the rational planning process*. It is therefore concerned with crafting a strategic position for the organisation based on attractiveness of industry and organisational capabilities.

From a knowledge perspective, the design school focuses on the role of formal analysis, planning and formal, strategic choice as essential activities that provide strategy-makers with the data essential for their task, highlighting the role of explicit knowledge (Salmador and Bueno, 2005:271).

The planning school, which originated at the same time as the design school, focuses on strategy as a **plan** with formal procedures, formal training, and formal analysis, guided by a specialised strategic planning department with direct access to the chief executive (Mintzberg *et al*, 1998:48). Conceived in the early 1980s, the **positioning** school accepted most of the premises underlying the planning and design schools, as well as their fundamental model, but it added content in two ways. It did so by emphasising the importance of strategies themselves, not just the process by which they were formulated, as well as focusing on the content of strategies in a more prescriptive manner, i.e. prescribing specific strategies available to organisations and the contexts in which each seemed to work best (Mintzberg *et al,* 1998:82).

### *The emergent approach to strategy-making*

The emergent approach is depicted in the bottom half of figure 3.1. The process is not as well delineated as that of the rational planning approach. A brief discussion on certain concepts that are associated with the emergent approach and that can be discerned from figure 3.1 follows:

The **strategy as an art** view (as opposed to strategy as a science) holds that strategies should be a creative adaptation to environmental challenges (Koch, 2000:81). According to the art perspective, the lack of environmental predictability and the fast pace of change suggest that the inherent value of strategic planning is limited. Instead, strategists should incorporate substantial creativity and intuition in order to design a comprehensive strategy for the firm (Ford & Gioia, 2000).

Emergent strategy is associated with the **organic** (as opposed to mechanistic) approach to strategy. The organic approach combines notions of process, unity, and vitality (Burns & Stalker, 1961, *in* Farjoun, 2002:562). The organic approach is particularly suitable in dynamic and uncertain environments. This view on strategy has been influenced by key developments including research on strategy formation and implementation (Quin, 1981; Mintzberg & Waters, 1985), and recognition of reciprocal and interactive relationships between strategy and other constructs (Henderson & Mitchell, 1997). These research streams have introduced new and eclectic views of key constructs, questioned the rational process model of strategy and offered new views on strategy formation. The focus of the organic perspective shifted from strategic choice to strategic change.

The learning approach to strategy is furthermore associated with the **learning approach** (as opposed to the design approach). Mintzberg (1990:181) notes that although the design school approach made a "profound contribution" to strategy, "it has never been good enough". He continues to dissect its premises and comes to the conclusion that it describes but one approach to strategy formation, and "even that one sometimes exhibits a level of generality and a tone of inevitability that seems overly simple in places and, at times, dogmatic". His critique of the design school revolves around one central theme: its promotion of thought independent of action, strategy formation above all as a process of conception, rather than as one of *learning* – as can be clearly seen in a fundamental step in the formulation process, the assessment of strengths and weaknesses. The formulation-implementation dichotomy, central to the design and planning schools, is a valid distinction for conceptual, analytical and even pedagogical purposes, but in organisations collapses because learning takes place along the way (Mintzberg, 1990:187).

The learning approach emphasizes the role of gathering experience. This school has long since adopted an implicit-knowledge and learning perspective in describing how strategies are formed (Salmador and Bueno, 2005:271).

In the same way that strategic learning is critical to an emergent approach; **strategic thinking** forms an integral part of the emergent approach to strategy. More than a decade ago the need to re-examine strategy paradigms was brought to the fore (Prahalad & Hamel, 1994:6), especially where strategic thinking was concerned. They maintain that many of the assumptions that were embedded in traditional strategy models may be incomplete and/or outdated as we approach the new competitive milieu. As such the need for strategic thinking and behaviour among managers has never been more urgent. This reality should force us to re-examine the traditional strategy paradigms.

Liedtka (1998, *in* Graetz, 2002:456) notes that strategic thinking reflects a systems or holistic view that appreciates how the different parts of the organisation influence and impinge on each other as well as their different environments. Strategic thinking embodies a focus on **intent,** in contrast with the traditional strategic planning approach that focuses on creating a fit between existing resources and emerging opportunities. Strategic thinking invokes the capacity to be 'intelligently opportunistic', to recognise and take advantage of newly emerging opportunities.

Strategic **intent** is linked to learning and strategic thinking in a decentralised environment and disintegrating organisational boundaries with more employees from different hierarchical levels joining in the strategic intent of the organisation (Liedtka & Rosenblum, 1996:42). Strategic intent is therefore associated with the emergent approach to strategy-making. Strategic intent shows to strategy as a **perspective** and strategic learning result in certain strategy **patterns** evolving in organisations.

Strategy as a **pattern** refers to strategy being translated as consistency in behaviour over time. Organisations can therefore be seen to develop plans for the future and also evolve patterns out of their past. The difference between the two main approaches to strategy-making (namely formal and emergent) is the difference between an *intended* strategy and on the other hand the *realised* strategy.

### 3.2.2 The Use Of Ends And Means To Describe The Opposing Approaches To Strategy-Making

Many early strategy authors include the concept of means and ends in their definition of strategy (Andrews, 1971; Chandler, 1962; Hofer & Schendel, 1978 *in* Brews & Hunt, 1999:890).

The distinction between means and ends has been used by Brews and Hunt (1999) to categorise different approaches to strategy-making. Ends are defined as (Brews & Hunt, 1999:891):

> the major, higher level purposes, mission, goals or objectives set by organizations, each of which (should there be more than one) significantly influences the overall direction and viability of the firm concerned;
>
> and means are defined as (Brews and Hunt, 1999:891):
>
> the patterns of action which marshal/allocate organizational resources into postures that, once implemented, increase the probability of attaining organizational ends.

The ends and means resulting from the emergent strategy-making approach are either specified simultaneously, or are intertwined (Fredrickson & Mitchell, 1984) and are rarely announced or recorded in a formal planning document, and when they are announced, they remain broad, general, and non-quantified (Quinn, 1980). Means develop and evolve over time as organisations learn from environmental interaction (Mintzberg, 1990). In contrast to the emergent approach, rational planning results in ends that are announced and recorded in a formal planning document. Means emerge from the planning process fully formed and ready for implementation.

### 3.2.3 Synthesis Of Strategy-Making Approaches

Andersen (2000:184) notes that there has been a tendency to de-emphasise the role of strategic planning in recent years and instead focus on management autonomy and organisational learning. He notices that despite the opposing views of contemporary scholars, most firms continue to plan for the future, which reveals a need to review the effects of strategic planning in conjunction with managers' autonomous actions. According to Andersen, past research on the performance effects of strategic planning has been inconclusive, and evidence of the strategic importance of adaptive actions taken by lower-level managers remains somewhat anecdotal. He states (2000:184):

> Some [contemporary scholars] argue that autonomous actions are imperative to strategic adaptation, while planning inhibits change. Conversely, others argue that centralized planning is needed to co-ordinate responsive actions and spur adaptive strategic thinking.

In an effort to clarify the above dilemma, Andersen (2000:184) reports on a research programme investigating the dual performance effects of strategic planning and autonomous actions (which he relates to the emergent approach to strategy-making) in the strategy formation process. The results of this research indicate that strategic planning has positive performance effects across industries, and exists in tandem with autonomous actions (emergent strategies), where managers make responsive decisions that enhance performance under changing environmental conditions.

## 4. RESEARCH METHODOLOGY

The research methodology below defines the construct of strategy-making and discusses the research design.

### 4.1 Defining The Research Construct

The following conceptual and operational definitions are derived from the above literature review:

It has been emphasizes that strategy creation should not necessarily be separated from implementation, but formulation and implementation can be seen as two integrated phases and on the whole an inseparable process. Contrasting views on this issue were outlined.

From this followed the *conceptual definition* of "strategy-making" as being the process of strategy creation whether separated from implementation or believed to be inseparably part of the implementation.

The classification of strategy-making approaches based on the outcomes (ends and means) proved important for this study as this led to the formulation of an *operational definition* that formed the critical foundation for the development of the research instrument (the questionnaire) as well as the data analysis.

- ***Operational definition of emergent approach to strategy-making:*** Ends and Means would be less specific and rarely announced or recorded in a formal planning document. It would prove more difficult to distinguish between ends and means since they are either specified simultaneously, or are intertwined. When they are announced, they remain broad, general, and non-quantified.
- ***Operational definition for rational planning approach to strategy-making:*** Ends and means are announced and recorded in a formal planning document and are very specific. Means emerge from the planning process fully formed and ready for implementation.

## 4.2 Sample Selection And Size

A sample had to be selected from the population of South African organisations. A non-probability purposive/judgmental sample has been used (meaning the sample was arbitrarily and subjectively selected (Cooper & Schindler, 2001:166) using judgment to select cases that will best enable the researcher to answer her research questions and meet objectives (Saunders *et al*, 2007:230). Because strategy is regarded as a confidential and sensitive area of research in most organisations, the study was in some instances met with resistance from organisations that were approached to participate in the research (especially where organisations operated in highly competitive environments). Participating organisations were therefore selected arbitrarily based on the access that the researchers had to either the CEO (through prior established relationships or network contacts) or a strategically positioned manager who directly influenced strategy-making in the organisation. Despite the arbitrary selection the respondents and interviewees were still measured against sample selection criteria for inclusion in the sample. Interviews were held with 17 CEOs or managers involved in strategy and each were requested to distribute questionnaires evenly between management (top-, middle- and lower-level management) and non-management level employees in their organisations. Ten to twenty questionnaires (depending on the organisational size) were distributed per organisation in order to spread respondents across several organisations and increase research validity. Some questionnaires were also distributed among individual organisations from an organisational database to which the researcher had access. A total of 210 questionnaires (including 17 questionnaires captured after interviews with CEOs) were returned.

The CEO/manager concerned with strategy that was interviewed represents an informant rather than a respondent. An **informant** can be defined as “one asked to provide information about a situation to which he or she has privileged access” (Julian and Ofori-Dankwa, 2008:102). A **respondent** is one asked to express a personal opinion (Julian and Ofori-Dankwa, 2008:102).

## 4.3 Research Design

Mixed model research was used where both quantitative and qualitative data collection techniques and analysis procedures were used and combined (Saunders et al, 2007:146). In this study qualitative data obtained through semi-structured personal interviews were “quantitised” (Saunders et al, 2007:146) and converted into numerical codes that could be analysed statistically. The outcomes of the interviews were firstly recorded in minutes and important issues captured in an excel spreadsheet and secondly, questionnaires were completed on behalf of the interviewee after the interview. The latter data sets (called the “informants”) were then compared to the first group of respondents.

# 5. RESEARCH FINDINGS AND CONCLUSIONS

Research findings and conclusions based on the primary objective to investigate and describe the mode of strategy-making followed in South African organisations, are presented below.

## 5.1 Factor Analysis

A factor analysis was done on the data to reduce the large number of variables contained in the questionnaires by means of a smaller set of composite variables (so called 'factors') and to aid in the substantive interpretation of the data (Diamantopoulos and Schlegelmilch 2005:216).

The factor analysis not only proved construct validity and reliability, but also indicated the critical constructs or themes emanating from the .questionnaire based on the responses. The three factors that emerged proved critical for the analysis that followed:

- **Factor 1**: **Performance Consensus**. This factor explains agreement among managers and organisational members on effectiveness of and satisfaction with the organisational strategy-making approaches and consequent strategies as well as organisational performance. Parnell (2000:49) argues that if consensus is linked to performance then one may argue that some competitive strategies lend themselves to greater agreement among managers. For this reason, he suggests that future studies should consider the perceptions of multiple top and functional managers. For example, consensus may be high among segment controllers where everyone seems to understand the niche being targeted by the business, but be low among first movers where the essence of the strategy is not always well understood (Wooldridge & Floyd, 1992).

  Variables associated with this factor tested on a scale with the value 1 indicating the *least* Performance Consensus and value 4 indicating the *most* Performance Consensus.

- **Factor 2: Ends and Means Specificity**. This factor explains the specificity of ends, defined as the major, higher level purposes, mission, goals or objectives set by organisations, each of which (should there be more than one) significantly influences the overall direction and viability of the firm concerned as well as the specificity of means defined as the patterns of action which marshal/allocate organisational resources into postures that, once implemented, increase the probability of attaining organisational ends. Variables associated with this factor tested on a scale with the value 1 indicating the *least* Ends and Means Specificity and value 4 indicating the *most* Ends and Means Specificity (in other words ranging from the emergent approach (scale value 1) to rational planning approach (scale value 4)).

- **Factor 3: Ends and Means Flexibility.** This factor explains the flexibility of planning structures, tolerance for change and flexibility of planning time frame as opposed to organisational rigidity. Variables associated with this factor tested on a scale with the value 1 indicating the *most* Ends and Means Flexibility and value 4 indicating the *least* Ends and Means Flexibility (in other words ranging from the emergent approach (scale value 1) to rational planning approach (scale value 4)).

### *Table 5.1 Univariate Statistics For Factor Analysis*

| | Performance consensus<br><br>(Factor 1) | Ends and Means specificity<br><br>(Factor 2) | Ends and means flexibility<br><br>(Factor 3) |
|---|---|---|---|
| Number of items | **8** | **6** | **3** |
| Mean[1] | **2.95** | **2.96** | **2.53** |
| Median[2] | **3** | **3** | **2.66** |
| Mode[3] | **3** | **3.5** | **2** |
| Standard Deviation | **0.58** | **0.69** | **0.93** |
| Variance | **0.33** | **0.48** | **0.87** |
| Variance explained *(total = 56%)* | **31%** | **17%** | **8%** |
| Cronbach's Alpha coefficient *(All = 0.87)* | **0.90** | **0.87** | **0.80** |
| Eigen value | **5.75** | **3.33** | **1.83** |
| Squared multiple correlation | **0.36** | **0.55** | **0.67** |
| Canonical correlation | **0.97** | **0.95** | **0.92** |

N=193

The overall Cronbach's Alpha coefficient value of 0.87 was obtained. Performance Consensus yielded a Cronbach's Alpha coefficient value of 0.90, Ends and Means Specificity 0.87 and Ends and Means Flexibility 0.80. Fifty six percent of the total variance has been explained by the factors. The means and modes for each of the factors have been shaded for ease of reference.

### *Table 5.2 Factor Correlations For Rotated Factors*

| | **Performance consensus** | **Ends and Means specificity** | **Ends and means flexibility** |
|---|---|---|---|
| **Performance consensus** | **1.000** | | |
| **Ends and Means specificity** | **0.186** | **1.000** | |
| **Ends and means flexibility** | **0.146** | **0.235** | **1.000** |

All three factors are weakly correlated and the factor structure was stable. As noted in table 5.2 these three factors explain 56% of the total variance.

It is important to note that the factors are weakly correlated. This shows that the factors are independent. Each factor therefore describes a distinct theme within the construct of strategy-making. Factors also proved to have high Cronbach Alpha's coefficients (see figure 5.1 below) which proves high reliability. Together the three factors explain the construct of strategy-making. Figure 5.1 below illustrates this.

[1] A measure of central tendency; the arithmetic average (Zikmund, 2005:738)
[2] A measure of central tendency that is the midpoint; the value below which half the values in a sample fall (Zikmund, 2005:738)
[3] A measure of central tendency; the value that occurs most often (Zikmund, 2005:738)

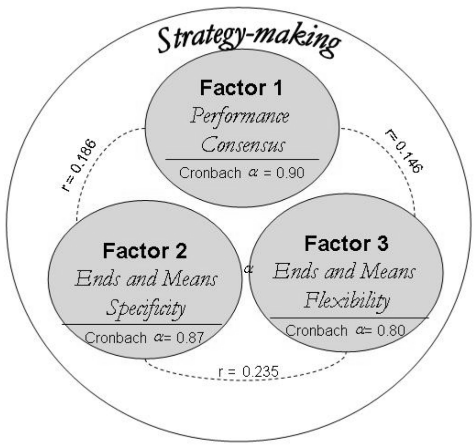



***Figure 5.1 Independent Factors And Their Correlations Forming The Construct Of Strategy-Making***

*(Source: Own compilation)*

It can be seen that Ends and Means Specificity (factor 2) and Ends and Means Flexibility (factor 3) each indicate scalable properties associated with rational planning on the one side and the emergent approach on the other side. In contrast, Performance Consensus (factor 1) does not indicate a continuum associated with two extreme strategy-making approaches. But as these factors together make up the construct of strategy-making, Performance Consensus (factor 1) describes a critical part of strategy-making (regardless of which one). The explanation for this is that it is the combination of Performance Consensus (factor 1) with Ends and Means Specificity (factor 2) and Ends and Means Flexibility (factor 3) that postulates a specific approach. Performance Consensus (factor 1) thus represents the neutral part of strategy-making.

Because all three factors are weakly correlated and thus represent independent aspects of the construct of strategy-making, hypothesis testing has to take this into account. Therefore if one or more of the factors proved to be significant, the null hypothesis is rejected even if the other factor/s was/were not significant. This is because each one of the factors individually describes some critical part of the construct of strategy-making.

## 5.2 Conclusion

## 5.2.1 Dominant Approach To Strategy-Making Followed

The factor averages and modes serve to describe the different approaches to strategy-making followed in organisations. Although the means seem similar, varying between 2.95 and 2.53, the modes provide a slightly different picture.

- The mode for Performance Consensus (factor 1) (= 3) shows an above average score.
- The mode for Ends and Means Specificity (factor 2) (= 3.5) shows that most respondents selected a high value for ends and means specificity in line with a more rational approach.
- The mode of Ends and Means Flexibility (factor 3) (= 2) shows that most respondents selected a value showing higher ends and means flexibility, in other words organisations were shown to be more flexible in line with a more emergent approach.

Based on the above statistics the **approach to strategy-making** can therefore be described as:

- Rational with *high ends and means specificity*, but
- *high flexibility* of planning structures and tolerance for change, as well as
- *high performance consensus* on strategy effectiveness and general satisfaction with strategy.

The approach to strategy-making was furthermore described through the application of a Mann-Whitney test showing significant differences between opposing **approach characteristics** as summarised below:

- *Degree of risk taking preferred*: Performance Consensus is significantly different ($F=1.0$, $p<0.01$) for respondents selecting low versus high degree of risk taking. The analysis showed that agreement on effectiveness of strategy (performance consensus) leads organisations to be more tolerant towards high risk-taking. In other words, if organisational members agree on the effectiveness of their strategies and if they are satisfied with and agree on strategy-making approaches followed, they tend to take greater risks.
- *Comfort with stability and predictability*: Ends and Means Specificity ($F=0.43$, $p<0.01$) and Ends and Means Flexibility ($F=3.97$, $p<0.01$) are significantly different for respondents selecting "comfort with stability and predictability" versus those selecting "comfort with ambiguity and instability". The analysis showed that comfort with stability and predictability leads organisations to determine highly specific ends and means and be less flexible (hence following a rational approach to strategy-making). This finding is hardly surprising since the predictability is associated with the rational planning approach (described by high specificity and low flexibility). As such this finding corresponds with the literature on rational planning.
- *Primarily autonomous or individual behaviour preferred:* Ends and Means Specificity (factor 2) is significantly different ($F=0.00$, $p<0.01$) for respondents selecting "primarily autonomous or individual behaviour" versus those selecting "primarily cooperative, interdependent behaviour". The analysis showed that organisations where primarily autonomous or individual behaviour is favoured determine less specific ends and means. This is a surprising finding since cooperative and interdependent behaviour is associated with the emergent approach in literature (Wooldridge and Floyd, 1994:51). However, it could be argued that higher levels of cooperation and interdependent behaviour require a more coordinated and more specific approach to strategy-making, such as the rational approach. Specific ends and means are then required to coordinate cooperation among organisational members.

The following conclusion can be drawn from the results of the informant interviews:

The majority of informants (67%) indicated that an emergent approach to strategy was followed where emergence of strategies are encouraged, but with discipline typically built into strategy-making through deliberate ends and means. In the interviews informants indicated certain types of strategies employed in their organizations. These strategies focus mainly on operations, marketing and product innovation and as such correspond with emergent strategies (Parnell, 2000:47) - again confirming the above-mentioned description of the dominant strategy-making approach.

### 5.2.2 Hypothesis testing

From the above discussion of the findings the following conclusion regarding the hypothesis can drawn.

The null hypothesis (as presented in paragraph 2.2) is *rejected* and the alternative hypothesis is therefore *accepted.*

*Motivation:* Factors identified corresponded with the operational definition of strategy-making and data analysis showed mode and mean values which were interpreted to suggest the prevalence of a specific mode of strategy-making. In addition, characteristics of opposing approaches were tested and significant differences ($p<0.01$) were found with regard to the three factors. It can be stated that the mode of strategy-making was clearly identified as a rational planning approach with flexibility regarding planning structures and tolerance for change built-in as well as a high level of consensus on strategy-making evident. This can hence be described as a combination of rational planning and emergent approaches (likened to planned emergence or a synthesis between approaches discussed in the literature review). This is also in line with the informants' view that strategy may emerge but ends and means are deliberate and provide organisational discipline.

# 6. CONTRIBUTION OF THE STUDY

This study set out to describe strategy-making approaches in South African organisations which has to date not been done. An array of empirical analysis techniques were applied and showed conclusively how strategy-making happens in South African organisations. The study therefore painted a picture of strategy-making in South African organisations which can be used as a point of departure for future research and academic inquiry. These conclusions proven through statistical analysis refute some assumptions made about strategy in literature.

The study therefore showed that reflecting only on one aspect or extreme of strategy-making to the exclusion of other views when conducting strategy research or training on strategy distorts the truth and reality of strategy-making and cripples the application of strategy in general.

Furthermore, defying critique on research methodology typically followed for strategy research (with dominance of qualitative research methods), this study made use of mixed method research. This enabled quantitative data (from questionnaires) to be corroborated with qualitative data (from interviews). Results were also quantified and a spread of data analysis techniques applied to provide the most reliable and valid results and conclusions.

Balogun, Huff and Johnson (2003:201) argue that there is a strong theoretic argument for more closely coordinating managers' agendas and those of management researchers. They emphasised that knowledge is produced in organisations and not just in universities, and as such must be studied in organisations. A research agenda that grows solely out of conversations with other academics is unlikely to reflect contemporary organisational realities. The study was therefore also conducted within organisations where the strategizing reality unfolded. The conclusions of this study came from within organisations as a result of the sample of respondents approached to participate in the study. All results and conclusions are based on quantifiable data obtained from managers and other employees involved in strategy and not just on academic theoretical assumptions. Therein lies an important contribution of this study.

The participation of top management in interviews as informants added depth and breadth of information. The fact that informants and respondents showed general agreement on their perceptions as measured in the questionnaires increased the reliability of the findings.

# 7. SUGGESTIONS FOR FUTURE RESEARCH

The study also explored the relationship between organisational dynamics such as managerial level and perceptions on strategy-making mode, the influence of certain factors on the selection of a strategy-making approach as well as the link between organisational performance and profitability and strategy-making approaches. These findings and conclusions will be presented in future research papers.

The literature review as well as the empirical testing highlighted some areas ripe for future research:

Farjoun (2002:562) claims that the 'mechanistic perspective' remains vital to the development of strategy research, teaching and practice. This suggests that academic teaching favours a specific approach (the rational planning approach) to strategy-making in their academic content. For this reason the relationship between what is being taught and the focus of strategy education at South African academic institutions could be placed under the revealing spot light of future empirical research. The assumption, argued by Mintzberg *et al*. (1998:7) is that literature influences practice. It was also established in this study that formal training in strategy influences perceptions on strategy and as such has value to the future employee for understanding and consequently influencing his/her organisation with regard to strategy-making. A possible research objective should be to investigate the relationship between what is taught at South African universities and strategy-making in organisations.

## REFERENCES


Andrews, K.R. 1981. Replaying the board's role in formulating strategy. *Harvard Business review,* May-June:18-28

Andersen, T.J. 2000. Strategic Planning, Autonomous Actions and Corporate Performance. *Long Range Planning*, 33:184-200.

Balogun, J., Huff, A.S. and Johnson, P. 2003. Three responses to the methodological challenges of studying strategizing. *Journal of Management Studies,* 40(January):197-224.

Baum, J.R. and Wally, S. 2003. Strategic decision speed and firm performance. *Strategic Management Journal,* 24:1107-1129.

Brews, P.J. and Hunt, M.R. 1999. Learning to plan and planning to learn: Resolving the planning school/learning school debate. *Strategic Management Journal,* 20(10):889-913.

Burns, T. and Stalker, G.M. 1961. *The Management of Innovation*. London: Tavistock.

Chandler, A.D 1962. *Strategy and Structure. Chapters in the history of the industrial enterprise.* Cambridge: MIT Press.

Christensen, C.R., Andrews, K.R., Bower, J.L., Hamermesh, G. and Porter, M. 1982. *Business Policy: Text and Cases.* 5th edn. Homewood: Irwin-IL.

Cooper, D.R. and Schindler, P.S. 2001. *Business Research Methods.* 7th ed. Boston: McGraw-Hill Irwin.

Cyert, R.M. and March, J.G. 1963. *A behavior theory of the firm*. Englewood Cliffs, NJ:Prentice Hall.

Diamantopoulos, A. and Schlegelmilch, B.B. 2000. *Taking the fear out of data analysis.* London: Thomson Learning.

Farjoun, M. 2002. Towards and organic perspective on strategy. *Strategic Management Journal,* 23(7):561-594.

Graetz, F. 2002. Strategic Thinking versus Strategic planning: towards understanding the complementarities. *Management Decision,* 40(5):456

Harrington, R.J., Lemak, D.J., Reed, R. & Kendall, K.W. 2004. A Question of Fit: The Links among Environment, Strategy Formulation, and Performance. *Journal of Business and Management,* 10(1):15-38.

Henderson, R. and Mitchell, W. 1997. The Interactions of organizational and competitive influences on strategy and performance. *Strategic Management Journal*, Summer Special issue 18:5-14.

Heracleous, L. 1998. Strategic thinking or strategic planning? *Long range planning,* 31(3):481-487.

Hilse, H. and Nicolai, A.T. 2004. Strategic learning in Germany's largest companies – Empirical evidence on the role of corporate universities within strategy processes. *The Journal of Management Development,* 23 (3/4):372-398.

Hofer, C. and Schendel, D. 1978. *Strategy formulation: Analytical Concepts.*

Inkpen, A. and Choudhury, N. 1995. The Seeking of strategy where it is not: Toward a theory of strategy absence, *Strategic Management Journal,* 16, 1995: 313-323

Julian, S.D. and Ofori-Dankwa, J.C. 2008. Toward an integrative cartography of two strategic issues diagnosis frameworks. *Strategic Management Journal,* 29:91-114.

Koch, R. 2000. *The Financial Times guide to Strategy – how to create and deliver a useful strategy.* 2nd edition. London: Financial Times Prentice Hall.

Lechner, C and Mueller-Stewens, G. 2002. Strategy process research: what do we know, what should we know?, IfB-Working Paper, St Gallen.

Liedtka, J.M. 1998. Linking strategic thinking with strategic planning. *Strategy and Leadership,* Sept/Oct:30-35.

Liedtka, J.M and Rosenblum, J.W. 1996. Shaping conversations: Making strategy, managing change. *California Management Review,* 39(1):141-157.

McGee, J.; Thomas, H. and Wilson, D. 2005. *Strategy: Analysis and Practice.* London and Boston: McGraw Hill.

Mintzberg, H. & McHugh, A. 1985. Strategy formulation in an adhocracy. *Administrative Science Quarterly,* 30: 160-197.

Mintzberg, H. & Waters, J. 1985. Of strategies deliberate and emergent. *Strategic Management Journal,* 6: 257-272.

Mintzberg, H. 1987. Crafting strategy. *Harvard Business Review,* 65(4):66-75.

Mintzberg, H. 1990. The Design School: Reconsidering the basic premises of strategic management. *Strategic Management Journal*, 11(3):171-195.

Mintzberg, H. 1994. Rethinking strategic planning, Part II: New roles for planners. *Long Range Planning,* 27(3):22-30.

Mintzberg, H., Ahlstrand, B. & Lampel, J. 1998. *Strategy Safari: The complete guide through the wilds of strategic management.* London: FT Prentice Hall.

Mintzberg, H., Ahlstrand, B. & Lampel, J. 2005. *Strategy bites back: It is far more, and less, that you ever imagined...*Harlow, London, England: FT Prentice Hall.

Nag, R.; Hambrick, D.C. and Chen, M-J. 2007. What is strategic management, really? Inductive derivation of a consensus definition of the field. *Strategic Management Journal,* 28:935-955.

Parnell, J.A. 2000. Reframing the combination strategy debate: defining forms of combination. *Journal of Applied Management Studies,* 9(1):33-54.

Parnell, J.A. and Lester, D.L. 2003. Towards a philosophy of strategy: reassessing five critical dilemmas in strategy formulation and change. *Strategic Change,* 12(6):291-303.

Pettigrew, A.M. 1992. The Character and significance of strategy process research. *Strategic Management Journal,* Winter 13:5-16.

Prahalad, C.K. and Hamel, G. 1994. Strategy as a field of study: Why search for a new paradigm? *Strategic Management Journal,* 15 (Summer special issue):5-16.

Quinn, J.B. 1980. Managing Strategic Change. *Sloan Management Review,* Summer:3-20.

Quinn, J.B. 1981. Formulating strategy one step at a time. *Journal of Business Strategy,* 1:42-63.

Regnér, P. 2005. Adaptive and creative strategy logics in strategy process. Strategy Process. *Advances in Strategic Management,* 22:189-211.

Salmador, M.P. and Bueno, E. 2005. Strategy-making as a complex, double-loop process of knowledge creation: Four cases of established banks reinventing the industry by means of the Internet. *Advances in Strategic Management (Strategy Process Issue),* 22:267-318

Saunders, M., Lewis, P., and Thornhill, A. 2007. *Research Methods for Business Students.* 4th edn. London: Pearson Education Limited.

Schendel, D. 1994. Introduction to "Competitive organizational behavior: toward an organizationally-based theory of competitive advantage". *Strategic Management Journal,* Winter Special Issue 15:1-4.

Schendel, D.E. and Hofer, C.W. 1978. *Strategy Formulation. Analytical concepts.* Boston: West Publishing Company.

Szulanski, G.; Porac, J. & Doz, Y. 2005. Strategy Process. *Advances in Strategic Management*, 22: xiii-xxxv.

Van de Ven, A.H. 1992. Suggestions for studying strategy process Research. *Strategic Management Journal,* 13:169-188.

Wooldridge, B. and Floyd, S.W. 1992. Middle management involvement in strategy and its association with strategic type: a research note. Strategic Management Journal 13(Special issue): 153–167.

Wooldridge, B. and Floyd, S.W. 1994. Dinosaurs or dynamos? Recognizing middle management's strategic role. *Academy of Management Executive,* 8(4):47–57.

Zikmund W.G. 2003. *Business research methods*. 7th ed. Ohio: Thomson Learning South-Western.

# BOARD COMPOSITION OF TURKISH LISTED COMPANIES:
# IS THERE ANY DIFFERENCE BETWEEN INDUSTRIES?

**İrge Şener**
**Çankaya University, Turkey**

**Meral Elçi**
**Gebze Institute of Technology, Turkey**

## ABSTRACT

*The research related with board of directors is an important research stream. Although, many relations were investigated, few research examined whether board characteristics differ between different industries. Boards of directors are important mechanisms for Turkish organizations, since the performance of most of the organizations is directly related with these groups. Therefore, it is important to understand the characteristics of these groups. In this study, board characteristics of the companies, which are defined as CEO duality, insider/outsider ratio and size of the board was compared by taking into consideration the industries that the companies operate. The sample of the study includes the companies which shares are publicly traded in İstanbul Stock Exchange. The results indicate that there exists no significant difference and any trend of board characteristics between the various industries, which leads to the conclusion that industry does not matter for board composition of Turkish organizations.*

***Keywords:*** *Board Size, CEO Duality, Insider/Outsider Ratio*

## INTRODUCTION

Hambrick and Mason's *(1984)* upper-echelon theory draw attention to the research on top level executives. There are various definitions about which of the executives of the organization form the upper echelons; boards of directors are considered to be one of them *(Finkelstein & Hambrick, 1990; Haleblian & Finkelstein, 1993)*. Most of the research on board of directors focus on some of the characteristics of board members. These characteristics that form the board composition are CEO duality, insider/outsider ratio and the size of the board which is defined as the number of the board members.

The relation between the composition of board of directors and organizational performance attracted the attention of many researchers *(Zahra & Pearce, 1989; Pettigrew, 1992; Forbes & Milliken, 1999)*. There exists a view in the literature about board of directors, that the financial performance of the organization is related with the structure of the board of directors *(Johnson et al, 1996; Pettigrew, 1992; Zahra & Pearce, 1989)*. Although, there is a widespread research on this relation, the findings are not consistent *(De Andres et al, 2005; Dulewicz & Herbert, 2004; Dalton et al, 1998)*. In this study, it is argued that the inconsistency of these research findings may be due to the contextual factors in which the organizations operate.

Although, there is numerous research on the effect of board composition on organizational performance, it is important to consider the contextual factors in relation to board characteristics *(Zahra & Pearce, 1989)*. In most of the past research on this relation, organizational context was not taken into consideration *(Boyd, 1990)*, which forms one of the major limitations of this research stream. Zahra and Pearce *(1989)* point that the current conditions that exist within and outside of the organization identifies the composition of the board characteristics, and therefore organizational performance which is the result of board performance. As an example, the authors suggest that the board characteristics of a newly formed company operating in a dynamic industry would need to be different from a well-established company operating in a mature industry. So that it is important to consider the effect of industry.

Although the intersection of the organization with its environment forms an important area of research in organizational theory and strategic management literatures (Keats & Hitt, 1988) and although the main focus of strategic management is its emphasis on the organization's competitive environment (Child, 1972; Porter, 1980); the environment is not generally taken into consideration in the studies related to upper-echelons. One of the most important criticism about this research focus on this issue, that in these studies the environment in which the organization and the group have their activities are not considered (Pettigrew, 1992).

Another criticism is that, many research related to the board composition is limited to US data *(Vafeas & Theodorou, 1998; Hyland & Marcellino, 2002)*. Therefore, research findings about the board composition of the organizations operating in other countries, and especially in developing ones will be an important contribution to the literature. Board of directors in Turkey has an important role on the decisions of organizations so the study of these groups exists as an important topic for research in Turkish context.

The organizational control mechanisms have common characteristics in developing countries, which is a central control mechanism that results from widespread family ownership, which is present even if in large scale organizations *(Yurtoğlu, 2000)*. It is evident that the family control in organizations is a common application in Turkey. The widespread organizational form apart from the public enterprises is the family organizations *(Gündüz & Tatoğlu, 2003)*. Furthermore, being highly-centralized approximately 80% of the publicly-traded organizations are controlled by families *(Ararat & Uğur, 2003)*. The form that is frequently observed and which can maintain the family control is the holding companies *(Buğra, 1994; Yurtoğlu, 2000)*. The family ownership and historical dependency to family resources increased the presence of family members in the management of the organization *(Gökşen & Üsdiken, 2001)*. In sum, the family members take place in the boards of both small and medium sized enterprises and also big scale publicly-traded organizations. The board of directors of Turkish organizations has a legal power for the control of institutional activities, therefore, boards of directors are an important disciplinary mechanism that both give advice and control the TMTs and also can supersede these groups when necessary *(Yurtoğlu, 2000)*.

In this study, considering these criticisms it was aimed to investigate the effect of the organizational context in terms of the industry in which the organizations operate in a developing country. After the review of the literature, methodology of the research is discussed and major findings are listed which is followed by the discussion and conclusion of the study.

## LITERATURE REVIEW

The research on the effect of the characteristics of board members to the organizational performance were undertaken within the frame of various theories (agency theory, Fama & Jensen, 1983; transactional cost theory, Williamson, 1985; institutional theory, Meyer & Rowan, 1977, DiMaggio & Powell, 1983; resource dependency theory, Pfeffer & Salancik, 1978).

Most of the research about the board of directors were related with agency theory (Zahra & Pearce, 1989). According to agency theory, boards of directors are assumed to be the groups which control the management for the sake of organizations' shareholders (Eisenhardt, 1989a; Zahra & Pearce, 1989). For this reason, the studies undertaken within the frame of agency theory focus to the processes that are inside the organization, and thus the organizational environment is not generally taken into consideration.

On the other hand, within the frame of resource dependency theory, boards of directors are considered to be boundary spanners of their organizations; and therefore they are the important actors which provide the management, necessary knowledge and resources for the activities of organizations (Zahra & Perace, 1989). One of the important principles of resource dependency theory is that the boards of directors reflect the features of the organizations' environments (Pfeffer, 1972; Boyd, 1990; Hillman et al, 2000). According to this theory, each board member brings in the organization, different connections and resources; in addition board members are selected according to their capabilities to assure important resources. Therefore, the structure of board of directors will be formed in accordance to the dependency of resource allocations of the organization (Hillman et al, 2000).

Institutional theory indicates that, organizations reflect the institutionalized and legitimized rules of their environments (Meyer & Rowan, 1977; DiMaggio & Powell, 1983). Different from the institutional and cultural perspectives, macro-institutional perspective draws attention to the multiple effects of the society in which the organizations activate. This perspective focuses on how the organizations are shaped under the effects of state, educational and financial systems, unions and work relations. Within the frame of institutional theory and macro-institutional perspective, it is argued that in general the structure of boards of directors is determined according to the institutionalized norms in the society and the organizational field. In some of the studies, it was found out that the social norms effect the selection of the CEO and the salaries of the managers (Zajac & Westphal, 1995, 1996). In most of the studies about the board of directors of Turkish companies, in general the effect of macro-institutional environment on boards of directors are taken into consideration (Yıldırım & Üsdiken, 2005; Üsdiken & Öktem, 2008).

The literature about the characteristics of boards of directors indicate that these research were rarely undertaken within the frame of contingency theory. This might be due to the fact that environmental conditions are not considered too much within these research stream. It was assumed within the contingency theory that the organizational effectiveness, structure and other features would be formed as a result of the fit to the contingencies which in fact reflects the conditions of organizations (Donaldson, 2001). In order that the organizations to continue their activities and to be effective, the organizational structure and processes would fit to the organizational context, which is determined as environment, technology, organizational size, organizational culture and task characteristics (Drazin & Van de Ven, 1985). Therefore, for organizational performance it is important that the organizational features to be in line with the environmental contingencies. Environment forms a major contingency for the organizations; since different environments have different economic, technical and social characteristics; the strategies and structures of the organizations that have activities in different environments are also different from each other. Accordingly, the fit of organizational structure to the environment is important for organizational effectiveness (Child, 1977; Drazin & Van de Ven, 1985; Donaldson, 2001).

This forms the motivation of this research and therefore the theoretical background for this study is the contingency theory. The implication from contingency theory is that there is not one best way of corporate governance and the structures of board of directors depend on the contextual factors. In order to understand the relation of the characteristics of board of directors with organizational performance, as a first step the environment in which the organization operates should be taken into consideration.

The research findings about the relation of top management team with organizational performance are similar with the results of the research on board of directors and organizational performance. Both of these research leads to inconsistent results. In corporate governance research, most of the attention is given to the board composition and its impact on firm performance. The most common measures of board composition are the number of directors, the insider/outsider ratio of the board and CEO duality (Zahra & Pearce, 1989; Johnson et al., 1996; Dalton et al, 1998, 1999). These research are based on the premise that boards of directors in general, and the compositional characteristics of boards in particular, should influence organizational performance. However, all of these measures of board composition resulted in inconsistent findings for organizational performance.

## Board Size

Jensen (1993) discusses the effectiveness of boards with more than seven to eight members. According to the author, coordination, communication and decision making will not be effective in large boards. In line with this, the results of the meta-analyses of Dalton et al (1999) demonstrate that board size is related to higher performance, and the effect was greater for smaller organizations. In addition, Yermack (1996) found out that smaller boards have a positive effect on performance. Whereas there are other studies in which the reverse relation is found to be true. Daily and Dalton (1993) and Walsh and Seward (1990) reported that larger boards performance is better.

## CEO Duality

When the CEO of the organization also acts as the chairman of the board, then the organization is said to have a dual-CEO. The research on the effects of CEO duality on organizational performance also yielded to inconsistent results. The findings of most of the studies indicate insignificant effects (Daily and Dalton, 1992, 1993; Rechner and Dalton, 1989; Baliga *et al*., 1996). In some studies, it was found out that CEO duality have a positive effect on organizational performance (Daily and Dalton, 1994), whereas some other studies indicate negative effect (Coles, McWilliams, and Sen, 2001; Rechner and Dalton, 1991).

## Insider/Outsider Ratio

Johnson, Daily and Ellstrand (1996) define inside directors as the directors who are also officers of the organization, and outside directors as all non-management members of the board. According to Forbes and

Miliken (1999), insider board members may view the board work as an extension of their managerial responsibilities, but it is more likely that outside board members view the tasks of the board as being distinctly different and complementary to that of management and these members are not interested in the daily operations of the organization. Although there are studies that indicate a positive relation between the percentage of outside directors and firm performance (Schellenger et al, 1989; Pearce & Zahra, 1992; Daily & Dalton, 1993), many more others indicate insignificant results (Daily & Johnson, 1997; Hermalin & Weisbach, 1991; Dulewicz & Herbert, 2004). The results of the meta-analyses on board composition and organizational performance by Dalton, Daily, Ellstrand and Johnson (1998) indicate insignificant relation of insider/outsider ratio and organizational performance. In addition, the results of another meta-analyses conducted by Wagner et al, 1998 indicate that board size may be more important for organizational performance instead of the number of insider and outsider directors.

Within this frame, in this study, it was aimed to understand whether or not there exists a difference between the boards of directors of organizations in terms of the board composition, according to the industry in which the organizations operate, and it was suggested that there exists a difference of board compositions of organizations between industries:

*$H_1$: The board compositions of the organizations differ according to the industries in which they operate.*

# METHODOLOGY

The purpose of this study was to investigate the board compositions of the companies whose shares are publicly traded in İstanbul Stock Exchange (İSE), in accordance to the industry in which they have their organizational activities. The research questions were:

- What is the average board size of the companies listed in İSE?
- Is CEO duality common between these companies?
- What is the average insider/outsider ratio for these companies?
- Do the board compositions of these companies differ according to the industries in which they operate?

It was suggested that the board compositions of the companies listed in İSE will differ from each other due to the specific characteristics of the industries which the companies should fit their board composition accordingly.

Websites of the companies are useful tools to communicate the company's values and policies. Publicly traded companies should have information related with their board of directors, announced via their web-pages according to the rules published by Capital Markets Board of Turkey. Data were collected through the websites of the companies whose shares are publicly-traded in the national market of İSE. The sample does not include the companies that are in secondary national market, watch-list companies market, new economy market, fund market, and the ones whose shares are temporarily forbidden from the transactions. Apart from 54 such companies; there are 287 companies whose shares are publicly traded in the national market, and the sample of this study contained all of these companies. Annual activity reports were investigated for the size of the board and CEO duality, and in addition corporate governance reports were investigated for insider/outsider ratio of the boards. After the collection of the data, the variables were coded and analyzed by SPSS 15.0. The descriptive statistics of the board compositions of the organizations are summarized below in Table-1:

**Table 1. Board Characteristics of the Sample**

| | **Minimum** | **Maximum** | **Mean** |
|---|---|---|---|
| Board Size | 3 | 15 | 6,56 |
| Number of Insiders | 0 | 7 | 1,23 |
| Number of Outsiders | 0 | 13 | 5,33 |
| Insider Ratio | 0,0 | 1,00 | 0,1922 |
| Outsider Ratio | 0,0 | 1,00 | 0,8078 |
| | | | |
| CEO Duality | **Frequency** | **Percent** | |
| *No Duality* | 128 | 44,6 | |
| *CEO is also Board Member* | 139 | 48,4 | |
| *CEO is also Chairman* | 20 | 7,0 | |

In most of the studies, organizational environment is considered as the industry that the organization operates. In this study, also industry was considered to be the organizational environment. The information about industry codes for these companies was available from Capital Markets Board and İSE. Initially, the number of the industries in which the companies operate were found out to be 48. In order to have a comparative basis between the industries, the industries were grouped under the wider industry codes and the total number of industries for the study was 28. The descriptive statistics for these industries are listed in Table-2.

**Table 2. Industries included in the Sample**

| Industry | Frequency | Percent |
|---|---|---|
| Mutual Funds | 35 | 12,2 |
| Textile & Clothing | 23 | 8,0 |
| Food & Beverage | 21 | 7,3 |
| Holding & Investment | 17 | 5,9 |
| Banking & Finance | 17 | 5,9 |
| Cement | 17 | 5,9 |
| Real Estate Investment | 13 | 4,5 |
| Iron, Steel & Metal | 13 | 4,5 |
| Technology & Communication | 12 | 4,2 |
| Chemicals | 11 | 3,8 |
| Electrical Equipments | 11 | 3,8 |
| Automotive | 10 | 3,5 |
| Paper | 8 | 2,8 |
| Petroleum & Coal | 8 | 2,8 |
| Glass, Glassware, Earthenware & Porcelain | 7 | 2,4 |
| Insurance | 7 | 2,4 |
| Leasing & Factoring | 7 | 2,4 |
| Publication | 6 | 2,1 |
| Metal Products | 5 | 1,7 |
| Other manufacturing | 5 | 1,7 |
| Retail Trade | 5 | 1,7 |
| Services | 5 | 1,7 |
| Tourism | 5 | 1,7 |
| Construction | 4 | 1,4 |
| Electricity, Gas & Steam | 4 | 1,4 |
| Sports | 4 | 1,4 |
| Transportation Services | 4 | 1,4 |
| Woodwork, Timber & Furniture | 3 | 1,0 |
| **Total** | **287** | **100,0** |

# FINDINGS

As demonstrated in Table-1, the board size of the organizations range from minimum 3 members up to 15 members at most. The boards are composed of approximately 7 members on the average. It can be observed that, most of the organizations operating in banking and finance industry have more than 8 board members; and besides, about 43% of the organizations operating in mutual funds industry have less than 5 board members (Table-3).

When insider and outsider directors are considered, it is noticed that the average of insider directors are much more less than outsider directors (Table-1). In Table-4, CEO duality is demonstrated taken the industries in which the organizations operate, into consideration. In about 45% of the organizations, the positions of CEO and chairman are separated from each other (Table-1). The separation of these roles is one of the major requirements of Capital Markets Board, and it is observed that most of the companies (93%) obey to this rule. However, although CEO duality is very low (7%), a board member to function as a CEO is a common application (48,4%) among the organizations. This emerges as another way of board control over the management of the organization.

On the other hand, the ANOVA analysis indicated that, there has been no statistically significant difference of the board size, CEO duality and insider/outsider ratio between the industries, which does not support the proposed hypothesis.

| Table 3. The number of Board Members by Industry | | | | |
|---|---|---|---|---|
| | Board Size | | | |
| **Industry** | **Less than 5 members** | **5-8 members** | **More than 8 members** | **Total** |
| Automotive | 0 | 8 | 2 | 10 |
| Banking & Finance | 0 | 5 | 12 | 17 |
| Cement | 0 | 11 | 6 | 17 |
| Chemicals | 1 | 9 | 1 | 11 |
| Construction | 0 | 3 | 1 | 4 |
| Electrical Equipments | 0 | 10 | 1 | 11 |
| Electricity, Gas & Steam | 0 | 4 | 0 | 4 |
| Food & Beverage | 4 | 14 | 3 | 21 |
| Glass, Glassware, Earthenware & Porcelain | 0 | 6 | 1 | 7 |
| Holding & Investment | 0 | 8 | 9 | 17 |
| Insurance | 0 | 5 | 2 | 7 |
| Iron, Steel & Metal | 3 | 8 | 2 | 13 |
| Leasing & Factoring | 0 | 7 | 0 | 7 |
| Metal Products | 1 | 4 | 0 | 5 |
| Mutual Funds | 15 | 20 | 0 | 35 |
| Other manufacturing | 0 | 3 | 2 | 5 |
| Paper | 0 | 5 | 3 | 8 |
| Petroleum & Coal | 0 | 6 | 2 | 8 |
| Publication | 0 | 5 | 1 | 6 |
| Real Estate Investment | 2 | 9 | 2 | 13 |
| Retail Trade | 0 | 2 | 3 | 5 |
| Services | 1 | 4 | 0 | 5 |
| Sports | 0 | 3 | 1 | 4 |
| Technology & Communication | 3 | 8 | 1 | 12 |
| Textile & Clothing | 5 | 16 | 2 | 23 |
| Tourism | 0 | 5 | 0 | 5 |
| Transportation Services | 0 | 3 | 1 | 4 |
| Woodwork, Timber & Furniture | 0 | 3 | 0 | 3 |
| **Total** | **35** | **194** | **58** | **287** |

| Table 4. CEO Duality by Industry | | | | |
|---|---|---|---|---|
| | Board Size | | | |
| **Industry** | **No Duality** | **CEO is also Chairman** | **CEO is also Board Member** | **Total** |
| Automotive | 5 | 0 | 5 | 10 |
| Banking & Finance | 0 | 2 | 15 | 17 |
| Cement | 13 | 2 | 2 | 17 |
| Chemicals | 4 | 1 | 6 | 11 |
| Construction | 1 | 0 | 3 | 4 |
| Electrical Equipments | 5 | 1 | 5 | 11 |
| Electricity, Gas & Steam | 1 | 0 | 3 | 4 |
| Food & Beverage | 13 | 2 | 6 | 21 |
| Glass, Glassware, Earthenware & Porcelain | 5 | 0 | 2 | 7 |
| Holding & Investment | 3 | 2 | 12 | 17 |
| Insurance | 0 | 0 | 7 | 7 |
| Iron, Steel & Metal | 8 | 0 | 5 | 13 |
| Leasing & Factoring | 1 | 0 | 6 | 7 |
| Metal Products | 2 | 0 | 3 | 5 |
| Mutual Funds | 17 | 3 | 15 | 35 |
| Other manufacturing | 1 | 1 | 3 | 5 |
| Paper | 5 | 0 | 3 | 8 |
| Petroleum & Coal | 6 | 0 | 2 | 8 |
| Publication | 4 | 0 | 2 | 6 |
| Real Estate Investment | 6 | 2 | 5 | 13 |
| Retail Trade | 3 | 0 | 2 | 5 |
| Services | 3 | 1 | 1 | 5 |
| Sports | 4 | 0 | 0 | 4 |
| Technology & Communication | 4 | 1 | 7 | 12 |
| Textile & Clothing | 8 | 1 | 14 | 23 |
| Tourism | 3 | 0 | 2 | 5 |
| Transportation Services | 2 | 0 | 2 | 4 |
| Woodwork, Timber & Furniture | 1 | 1 | 1 | 3 |
| **Total** | 128 | 20 | 139 | 287 |

# DISCUSSION AND CONCLUSION

The board compositions of publicly traded Turkish organizations were examined with this study. The results of this research indicate that board composition of these organizations in terms of their number of board members, CEO duality and insider/outsider ratios of the directors; do not significantly differ between the industries in which the organizations operate. Although, Yurtoğlu (2000) in his research found out that board size differ significantly between different industries, the findings of this study are not similar. According to the results of Yurtoğlu's (2000) research, holding companies and financial companies have larger boards than manufacturing companies. The conflicting findings of this study, with the study of Yurtoğlu are probably due to effect of time. Yurtoğlu's research was conducted with 1998 data, and the data for this study was from 2008. The results of this current study indicate that within 10 years time, board size of the companies operating in different industries converged to each other.

With this study, it was found out that the average number of board members is approximately 7, outsider directors are more common for the management and although most of the chairmen do not hold the position of CEO at the same time, instead one of the board members holding the CEO position is a common application among the organizations. This board member is usually the vice chairman. This is an implicit indication of board control over the management. From one side, the organizations obey the requirements of Capital Markets Board but on the other side they still maintain the control.

The findings of this study suggest that industry does not make a significant difference between the boards of the organizations. This may be related to the representation of most of the family members as board of directors. Since family members dominate the boards of the organizations, industry specific features might not matter for the organizations. Similarly, Yurtoğlu (2000), in his study examining 257 publicly traded Turkish companies, also found out that the majority of the companies investigated were ultimately dominated and controlled by families. This result is also supported with another study of Yurtoğlu (2003) in which 305 publicly listed companies was investigated.

Although this study enhances the understanding of the board composition of publicly traded organizations, further research on the topic should also address the relation of board composition with the organizational performance between different industries. This relation was not taken into consideration which forms the major limitation of the study.

Despite this limitation, it is to our knowledge that there are no empirical studies that address industry differences of board composition of organizations in terms of the three dimensions in Turkey. Further research in this area might increase awareness and understanding of the effect of different contextual factors other than the industry on the board composition of the organizations.

# REFERENCES


Ararat, M. and Ugur, M. (2003), Corporate Governance in Turkey: An Overview and Some Policy Recommendations, *Corporate Governance: International Journal of Business in Society,* 3(1): pp.58–75.

Baliga, B.R., Moyer, R.C. and Rao, R.S. (1996), CEO Duality and Firm Performance: What's the Fuss?, *Strategic Management Journal,* 17(1), pp.41–53.

Boyd, B. (1990), Corporate Linkages and Organizational Environment: A Test of the Resource Dependence Model, *Strategic Management Journal,* 11, pp.419-430.

Buğra, A. (1994), Devlet ve İşadamları (State and Business), in Turkish. İstanbul. İletişim Yayınları.

Child, J. (1972), Organization Structure, Environment and Performance: The Role of Strategic Choice, *Sociology,* 6, pp.1–22.

Child, J. (1977), Organizational Design and Performance: Contingency Theory and Beyond, *Organization and Administrative Science,* 8, pp.169–183.

Coles, J., McWilliams, V. and Sen, N. (2001), An Examination of the Relationship of Governance Mechanisms to Performance, *Journal of Management,* 27(1), pp.23–55.

Daily, C. and Dalton, D. (1992), The Relationship between Governance Structure and Corporate Performance in Entrepreneurial Firms, *Journal of Business Venturing,* 7(5), pp.375–386.

Daily, C. and Dalton, D. (1993), Board of Directors Leadership and Structure: Control and Performance Implications, *Entrepreneurship Theory and Practice,* Spring, pp.65–81.

Daily, C. and Dalton, D. (1994), Corporate Governance and the Bankrupt Firm: An Empirical Assessment, *Strategic Management Journal,* 15(8), pp.643–654.

Daily, C. and Johnson, J. (1997), Sources of CEO Power and Firm Financial Performance: A Longitudinal Assessment, *Journal of Management,* 23(2), pp.97–117.

Dalton, D.R., Daily, C.M., Ellstrand, A.E., and Johnson, J.L. (1998), Meta-Analytic Reviews of Board Composition, Leadership Structure and Financial Performance, *Strategic Management Journal,* 19(3), pp.269–290.

Dalton, D.R., Daily, C.M., Johnson, J.L. and Ellstrand, A.E. (1999), Number of Directors and Financial Performance: A Meta-Analysis, *Academy of Management Journal,* 42(6), pp.674–686.

De Andres, A. P. and Lopez, F. (2005), Corporate Boards in OECD Countries: Size, Composition, Functioning and Effectiveness, *Corporate Governance: An International Review,* 13, pp.197–210.

DiMaggio, P.J. and Powell, W.W. (1983), The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields, *American Sociological Review,* 48(2), pp.147-160.

Donaldson, L., (2001), The Contingency Theory of Organizations, Thousand Oaks, CA: Sage Publications.

Drazin, R. and Van de Ven, A.H. (1985), Alternative Forms of Fit in Contingency Theory, *Administrative Science Quarterly,* 30, pp.514–539.

Dulewicz, V. and Herbert, P. (2004), Does the Composition and Practice of Boards of Directors Bear Any Relationship to the Performance of their Companies?, *Corporate Governance: An International Review,* 12, pp.263–280.

Eisenhardt, K.M. (1989), Agency Theory: An Assessment and Review, *Academy of Management Review*, 14, pp.57–74.

Fama, E. F. and Jensen, M. C. (1983), Separation of Ownership and Control, *Journal of Law and Economics,* 26, pp.301–325.

Finkelstein, S. and Hambrick, D.C (1990), Top-Management-Team Tenure and Organizational Outcomes: The Moderating Role of Managerial Discretion, *Administrative Science Quarterly,* 35, pp.484–503.

Forbes, D.P. and Milliken, F.J. (1999), Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups, *Academy of Management Review,* 24(3), pp.489–505.

Gökşen, N.S. and Üsdiken, B. (2001), Uniformity and Diversity in Turkish Business Groups: Effects of Scale and Time of Founding, *British Journal of Management,* 12(4), pp.325–340.

Gündüz, L. and Tatoğlu, E. (2003), A Comparison of the Financial Characteristics of Group Affiliated and Independent Firms in Turkey, *European Business Review,* 15(1), pp.48–54.

Haleblian, J. and Finkelstein, S. (1993), Top Management Team Size, CEO Dominance and Firm Performance: The moderating roles of environmental turbulence and discretion, *Academy of Management Journal,* 36, pp.844–863.

Hambrick, D.C. and Mason, P.A. (1984), Upper Echelons: The Organization as a Reflection of Its Top Managers, *Academy of Management Review,* 9(2), pp.193–206.

Hermalin, B. and Weisbach, M. (1991), The Effects of Board Composition and Direct Incentives on Firm Performance, *Financial Management,* 20(4), pp.101–112.

Hillman, A.J., Cannella, A.A. and Paetzold, R.L. (2000), The Resource Dependence Role of Corporate Directors: Strategic Adaptation of Board Composition in Response to Environmental Change, *Journal of Management Studies,* 37, pp.235–254.

Hyland, K.K. and Marcellino, P.A. (2002), Examining Gender on Corporate Boards: A Regional Study, *Corporate Governance,* 2, pp.24–31.

Jensen, M.C. (1993), The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems, *Journal of Finance,* 48, pp.831–880.

Johnson, J.L., Daily, C.M. and Ellstrand, A.E. (1996), Boards of Directors: A Review and Research Agenda, *Journal of Management,* 22(3), pp.409–438.

Keats, B.W. and Hitt, M.A. (1988), A Causal Model of Linkages among Environment Dimensions, Macro-organizational Characteristics, and Performance, *Academy of Management Journal,* 31, pp.570–598.

Meyer J. W. and Rowan B. (1977), Institutionalized Organizations: Formal Structures as Myth and Ceremony, *American Journal of Sociology,* 83, pp.340–363.

Pearce, J. and Zahra, S. (1992), Board Composition from a Strategic Contingency Perspective, *Journal of Management Studies,* 29(4), pp.411–438.

Pettigrew, A.M. (1992), On Studying Managerial Elites, *Strategic Management Journal,* 13, pp.163–182.

Pfeffer, J. (1972), Size and Composition of Corporate Boards of Directors, *Administrative Science Quarterly*, 21, pp.218–228.

Pfeffer, J. and Salancik, G.R. (1978), The External Control of Organizations: A Resource Dependence Perspective. New York: Harper & Row.

Porter, M.E. (1980), Competitive Strategy: Techniques for Analyzing Industries and Competitors. New York.

Rechner, P. and Dalton, D. (1989) The Impact of CEO as Board Chairperson on Corporate Performance: Evidence vs. Rhetoric, *Academy of Management Executive,* 3(2), pp.141–143.

Rechner, P. and Dalton, D. (1991), CEO Duality and Organizational Performance: A Longitudinal Analysis, *Strategic Management Journal*, 12(2), pp.155– 160.

Schellenger, M. H., Wood, D. D. and Tashakori, A. (1989), Board of Director Composition, Shareholder Wealth and Dividend Policy, *Journal of Management,* 15, pp.457–467.

Üsdiken, B. and Öktem (Yıldırım), Ö. (2008), Kurumsal Ortamda Değişim ve Büyük Aile Holdingleri Bünyesindeki Şirketlerin Yönetim Kurullarında "İcrada Görevli Olmayan" ve "Bağımsız" Üyeler (in Turkish). *Amme İdaresi Dergisi,* 41(1), pp.43–71.

Vafeas, N. and Theodorou, E. (1998), The Relationship between Board Structure and Firm Performance in the UK, *British Accounting Review,* 30, pp.383–407.

Wagner, J., Stimpert, J. and Fubara, E. (1998), Board Composition and Organizational Performance: Two Studies of Insider/Outsider Effects, *Journal of Management Studies,* 35(5), pp.655–677.

Walsh, J. and Seward, J. (1990), On the Efficiency of Internal and External Corporate Control Mechanisms, *Academy of Management Review,* 15(3), pp.421–458.

Williamson, O. (1985), The Economic Institutions of Capitalism. New York: The Free Press.

Yermack, D. (1996), Higher Market Valuations for Firms with a Small Board of Directors, *Journal of Financial Economics,* 40(2), pp.185–211.

Yıldırım, Ö. And Üsdiken, B. (2005), Boards of Directors in Firms within Family Business Groups: Evidence from Turkish 'Holding' Companies, *Paper submitted for 21st EGOS Colloquim,* Berlin, Germany, 30 June– 2 July.

Yurtoglu, B.B. (2000), Ownership, Control and Performance of Turkish Listed Firms, *Empirica,* 27, pp.193–222.

Yurtoğlu, B.B. (2003), Corporate Governance and Implications for Minority Shareholders in Turkey, *Corporate Ownership and Control,* 1(1): 72-86.

Zahra, S.A. and Pearce, J.A. (1989), Boards of directors and corporate financial performance: A review and integrative model, *Journal of Management,* 15, pp.291–334.

Zajac, E.J. and Westphal, J.D. (1996), Who shall succeed? How CEO/Board Preferences and Power Affect the Choice of New CEOs, *Academy of Management Journal*, 39, pp.64-90.

Zajac, E. J. and Westphal, J. D. (1995), Accounting for the Explanations of CEO Compensation: Substance and Symbolism, *Administrative Science Quarterly*, 40, pp.283–306.

# *FINANCE, ENTREPRENEURSHIP & SMES*

# THE STOCK MARKET EFFICIENCY AND INVESTMENT STRATEGIES DURING GLOBAL FINANCIAL CRISIS: A COMPARISON OF DEVELOPED COUNTRIES AND TURKEY

**Sudi Apak**
**Beykent University, Turkey**

**Kamer Hagop Taşcıyan**
**Kadir Has University, Turkey**

## ABSTRACT

*The global credit crisis which was started at the third quarter of 2008 is spread rapidly from U.S. to all developed and developing countries and it affected the whole financial system. Since the beginning of the 2008, the losses in some of the stock exchange reached at fifty percent of their index values.*

*In order to decrease losses and prevent investors from financial crisis, it is needed to determine alternative investment strategies. In this study, BCC model (return to variable) of measuring stock market efficiency and the best investment strategies are considered. For market efficiency of stock markets in Turkey, U.S., Germany, U.K., Japan, Brazil, Russia, China and Hong Kong, four-month weekly standard deviation as input and mean return as output are used. Analysis results show that Investment Strategy of D is the best diversified investment strategy among others which is taken as an equal weight of twenty five percent of European and U.S. stock exchanges in the study. Whereas the most efficient undiversified investment strategy is Shangai (China) stock market and the least efficient undiversified investment strategy is RTS (Russian) stock market.*

***Keywords:*** *Global financial crisis, stock market efficiency, investment strategies, data envelopment analysis*

## 1. INTRODUCTION

Originally, DEA was developed to measure efficiency of a decision making unit (DMU) such as firm or a public-sector agency, first introduced into Operational Research literature by Charnes, Cooper and Rhodes (CCR) in 1978. The original CCR model was applicable only to technologies characterized by constant return to scale globally. In what turned out to be a major breakthrough, Banker, Charnes and Cooper (BCC) extended the CCR model in 1984. The BCC model accomodate the technologies that exhibit variable return to scale (Ray, 2004).

DEA models forms a production possibility frontier, or an efficient surface. In DEA for evaluating the relative efficiency of comparable entities referred to as Decision Making Units. So if a DMU lies on the surface, i.e. there is no other DMU that can either produce the same outputs by consuming less inputs (input oriented DEA) or produce more outputs by consuming the same amount of inputs (output oriented DEA), it is referred to as an efficient unit, otherwise inefficient. DEA also provides efficiency scores and reference units for inefficient DMUs. The efficiency score tells the percentage by which a DMU should decrease its inputs (input oriented DEA) or increase its outputs (output oriented DEA) in order to become efficient. Reference units are hypothetical units on the efficient surface which can be regarded as target units for inefficient units. They are in the traditional DEA obtained by projecting an inefficient DMU radially to the efficient surface (Joro,1998).

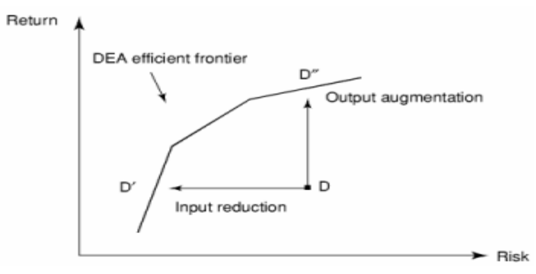
Data envelopment analysis (DEA) is a nonparametric method from the area of operations research that measures the relationship of produced outputs to assigned inputs and determines an efficiency score. This efficiency score can be interpreted as a performance measure in investment analysis (Eling, 2006). So we organize the rest of the paper as follows, Section 2 introduces the DEA methodological framework, Section 3 describes empirical analysis in stock markets. In Section 4, we conclude efficiency score results of stock market and investment strategies. The last section contains main results and findings of the study.

## 2. METHODOLOGICAL FRAMEWORK

Charnes, Cooper and Rhodes (1978) proposed a model that assumes constant returns to scale, called CRS or CCR. Subsequent works assumed different sets of suppositions, like the model developed by Banker, Charnes and Cooper (1984), which assumed variable returns to scale, called VRS or BCC. Both models can be classified as input oriented or output oriented, depending on the search for goals by the inefficient units (Lopes et al, 2008).

The DEA is a mathematical programming technique originally proposed by Charnes et al. (1978). The technique aims to evaluate the relative efficiency of a number of homogeneous units in transforming inputs into outputs. A unit is defined efficient (efficiency rating equal to 100%) if no other unit in the data set can produce more outputs using the same inputs, or the same outputs using less inputs. Conversely, if a particular unit in the data set is better than the unit under consideration (also known as the base unit), in that it can produce more outputs with the same inputs or the same outputs with less inputs, then the base unit is defined inefficient. Moreover, DEA can obtain target values based on the best practice units (peers) for each inefficient unit, which can be used to provide guidelines for improved performance. For example (Figure1) illustrates the basic concept of DEA and how DEA identifies the efficient frontier and establishes benchmarking standards. In Figure, the x-axis represents the standard deviation and y-axis represents the return. Using linear programming technique, DEA identifies a piecewise linear efficient frontier-the solid line. No other observed DMUs have a better return-risk combination than those DMUs on the identified DEA efficient frontier. For DMU D who is termed as (DEA) inefficient, to improve its efficiency, its risk should be reduced to that of $D'$ on the efficient frontier, or its return should be increased to that of $D''$ . $D'$ or $D''$ then is identified as the benchmark for DMU D.

**Figure 1:** DEA Efficient Frontier




**Source:** Gregoriou and Zhu, 2005

Consider a set of homogeneous decision making units (DMUs) j . 1; 2; . . . ; n. The following formulation (M1), when applied to the base unit B, can be used to establish its efficiency EB: Values of EB less than 1 imply that DMU B is underperforming compared with the other DMUs (Soterriou and Zenios, 1999)

(1)

$$\text{(M1)} \qquad \text{maximize} \quad E_B = \frac{\sum_{r=1}^{S} u_{rB} y_{rB}}{\sum_{i=1}^{L} v_{iB} x_{rB}}$$

(2)

$$\text{subject to:} \quad \frac{\sum_{r=1}^{S} u_{rB} y_{rj}}{\sum_{i=1}^{L} v_{iB} x_{ij}} \leqslant 1 \quad \text{for all} \quad j = 1, 2, \ldots, n,$$

(3)

$$u_{rB}, v_{iB} \geqslant 0 \quad \text{for all} \quad i = 1, 2, \ldots, L, \text{ and } \quad r = 1, 2, \ldots, S,$$

where yrj is the observed quantity of output r . 1; 2; . . . ; S; produced by unit j . 1; 2; . . . ; n, xij the observed quantity of input i . 1; 2; . . . ; L; used by unit j . 1; 2; . . . ; n, urB the weight (to be determined) given to output r by the base unit B, and viB the weight (to be determined) given to input i by the base unit B.

The fractional programming model above can easily be solved by transforming it into a linear programming model; the following formulation is known in the literature as the CCR model (Charnes, Cooper and Rhodes,1978, 1981)[4];

(4)

$$\text{(M1}') \qquad \text{maximize} \quad E_B = \sum_{r=1}^{S} u_{rB} y_{rB}$$

(5)

$$\text{subject to:} \quad \sum_{i=1}^{L} v_{iB} x_{iB} = 1,$$

(6)

$$\sum_{r=1}^{S} u_{rB} y_{rj} - \sum_{i=1}^{L} v_{iB} x_{ij} \leqslant 0 \quad \text{for all} \quad j = 1, 2, \ldots, n,$$

(7)

$$u_{rB}, v_{iB} \geqslant 0 \quad \text{for all} \quad i = 1, 2, \ldots, L, \text{ and } r = 1, 2, \ldots, S.$$

[4] An output oriented formulation can also be obtained by setting the numerator of Eq. (1) to an arbitrary constant and minimizing the denominator.

The decision variables for this fractional linear program are the set of weights of the inputs and outputs, v and u respectively. Thus, for each DMU the model will choose those weights which maximize its efficiency, subject to the constraint that no other DMU using the same set of weights can achieve an efficiency rating of higher than 1. A rating of 1 will deem the DMU efficient, with respect to the rest of the DMUs in the group.

Banker et al. (1984) extended the CCR model by relaxing the assumption of constant returns to scale. The resulting model - known as the BCC model - is used to assess the efficiency of DMUs with production process characterized by variable returns to scale. BCC models is used the same formulation as CCR models. The CCR model is the same as the BCC model except for the removal of the convexity constraint and the concesponding variable in the dual problem (Tam, 1999).

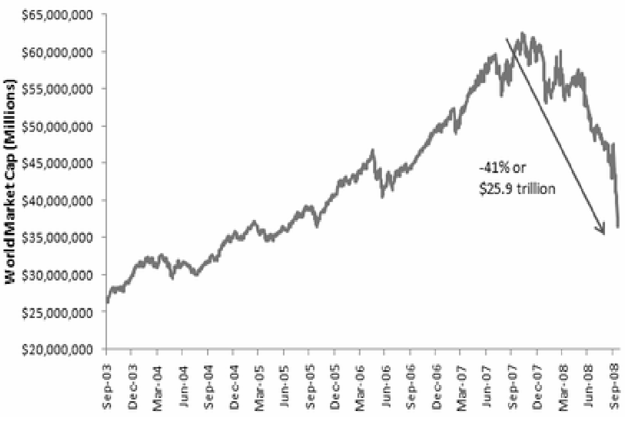
Over the last few years a number of other models have been developed to extend the original CCR model, and DEA has become a popular benchmarking technique (Soterriou and Zenios 1999). Currently, the DEA database has registered 3,203 publications written by 2,152 distinct authors (Tavares, 2002). Indeed, at present moment, an Internet search for DEA produces no fewer than 12,700 entries (Ray, 2004).

# 3. EMPIRICAL ANALYSIS IN STOCK MARKETS

Stock market, or equity market, is a private or public market for the trading of company stock and derivatives of company stock at an agreed price; these are securities listed on a stock exchange as well as those only traded privately. The size of the world stock market is estimated at about $36.6 trillion US at the beginning of October 2008.

(Figure 2) Since last October, the value of stocks worldwide has fallen 41%, or $25.9 trillion. As shown in the figure below, Bloomberg's World Market Cap index has fallen from $62.5 trillion at its peak on October 31st, 2007 to its current level of $36.6 trillion (Bloomberg World Market Cap Data (http://seekingalpha.com/article/99256-world-equity-market-declines 25-9-trillion).

**Figure 2:** Bloomberg World Market Cap




**Source:** Bloomberg World Market Cap Data, http://seekingalpha.com/article/99256-world-equity-market - declines-25-9-trillion

In this paper in order to determine the efficiency score of stock market we use DEA Solver (V3) software[5]. This papers aims to find;

- Which is the most efficient stock market during the global financial crisis?
- Which is the least efficient stock market during the global financial crisis?
- Which stock market (index) investment strategies are better to invest during the global financial crisis?

## 3.1 Methods

In this paper we use traditional DEA approach that enables to find that the best frontier (stock indexes) and diversified stock index investment strategies during the global financial crisis. The approach is based on BCC model (input oriented) for measuring technical efficiency of DMUs.

## 3.2 Data Collection

We undertook an empirical study at major and developing stock indexes to demonstrate the applicability of the BCC model presented in the previous section. We obtained Turkish Stock Market data from ISE (ISE, http://www.ise.org/data.htm) and U.S., Germany, U.K., Japan, Brazil, Russia, China and Hong Kong stock market data from Reuters (Reuters, http://www.reuters.com/finance/markets) for the weekly return and standard deviation (total risk) date of September 2008- December 2008.

### 3.2.1 Risk Calculation (Input)

The standard deviation (total risk) is often used by investors to measure the risk of a stock or a stock portfolio. The basic idea is that the standard deviation is a measure of volatility: the more a stock's returns vary from the stock's average return, the more volatile the stock. Stock market index standard deviation is calculated as follows;

(8)

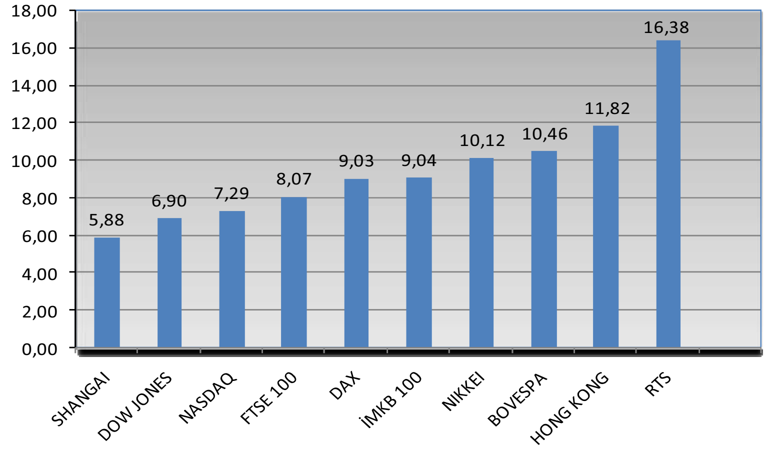
$$\sigma = \sqrt{\frac{\sum_{t=1}^{T} (r_t - \bar{r}_a)^2}{(T-1)}}$$

$\sigma$ : Standard deviation
**T** : Number of weeks which standard deviation is calculated
$r_t$ : Index weekly return
$\bar{r}_a$ : Index mean return.

In order to calculate efficiency score for related DMUs, the standard deviation is used as input. (Figure 3) According to the input results the most riskless undiversified stock index investment strategy is Shangai (China) stock market. Hence the most risky undiversified stock index investment strategy is RTS (Russian) stock market.

[5] It is common practice to evaluate stock markets and investment strategies by measuring their past performances or efficiencies, even if nothing ensure that the same return paths will occur again in the future.

**Figure 3 :** Stock Markets Standard Deviation (September-December 2008)




## 3.2.2 Return Calculation (Output)

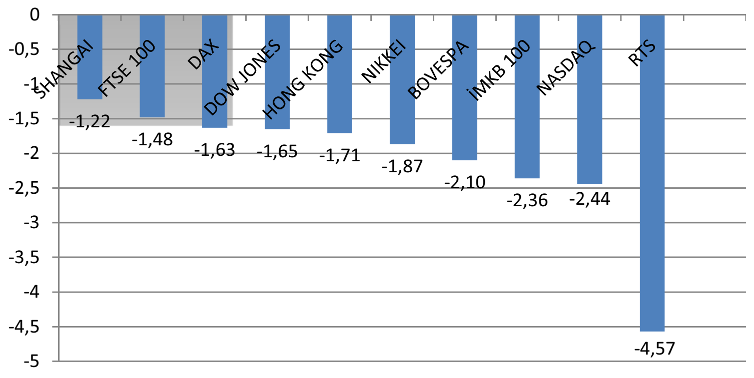
Mean return is the best way to fallow stock market performance. A lot of individual and corporate investor use return as a naive performance proxy. Stock market index returns are calculated as follows;

$$r_i = \frac{V_t - V_{t-1}}{V_{t-1}} \tag{9}$$

**$r_i$** : Index weekly return
**$V_t$** : Index price at t
**$V_{t-1}$** : Index price of the preceding week

In order to calculate efficiency score for related DMUs, the mean return is used as output. (Figure 4) According to mean return the best undiversified stock market investment strategy is Shangai (China) stock market. Hence the worst undiversified stock index investment strategy is RTS (Russian) stock market.

**Figure 4 :** Stock Markets Mean Return-Percentage (September-December 2008)




## 3.3 Alternative Stock Market Investment Strategies

In finance, an investment strategy is a set of rules, behaviors or procedures, designed to guide an investor's selection of an investment portfolio. Usually the strategy will be designed around the investor's risk-return tradeoff: some investors will prefer to maximize expected returns by investing in risky assets, others will prefer to minimize risk, but most will select a strategy somewhere in between.

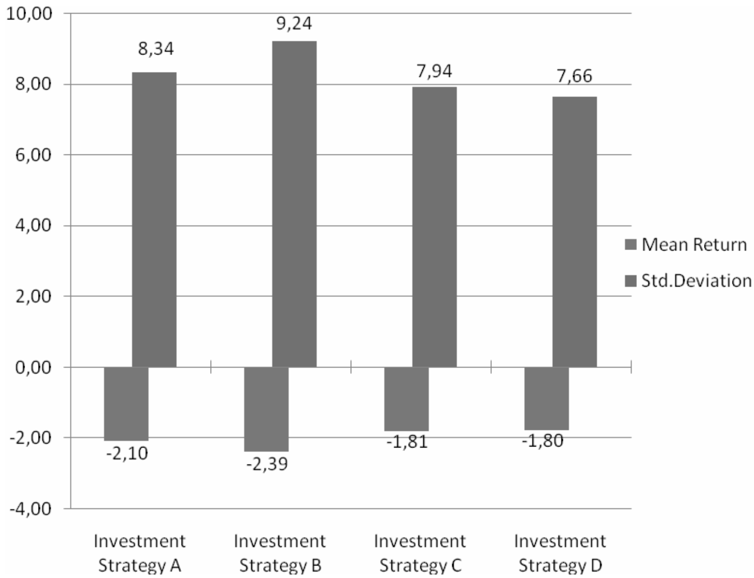
During the financial crisis to find or select optimal stock market investment strategies is getting important for individual and even corporate (such as pension, mutual or hedge funds) investors. The optimal portfolio may be defined in two ways which are equivalent. It represents a basket of securities with the highest expected return for a given amount of risk, or for a given amount of expected return the basket has the lowest possible volatility. The prudent investor is therefore not simply diversified, but diversified in a portfolio along the efficient frontier. (Table 1) We categorize stock market investment strategies in four different ways;

**Table 1** : Stock Market Investment Strategies

| **Stock Market Investment Strategies (Type)** | **Stock Market Investment Share (%)** |
|---|---|
| Investment Strategy A (Equally Balanced Stock Market) | Weighted equally of 10% (All the stock indexes analyzed in this study) |
| Investment Strategy B (Only Developing Countries) | Shangai, Hong Kong, Bovespa, İMKB 100 and RTS weighted equally of 20% |
| Investment Strategy C (Only Developed Countries) | Nikkei, Dow Jones, Dax, FTSE 100 and NASDAQ weighted equally of 20% |
| Investment Strategy D (Only US and Europe Stock Market) | Dow Jones, NASDAQ, FTSE 100 and DAX weighted equally of 25% |

(Figure 5) The results are concluded that the least risky investment strategy is Investment Strategy D and the most risky investment strategy is Investment Strategy B. Furthermore the best mean return is obtained from Investment Strategy D and the worst mean return is obtained from Investment Strategy B.

**Figure 5 :** Stock Index Investment Strategies Return (%) and Risk (September - December 2008)

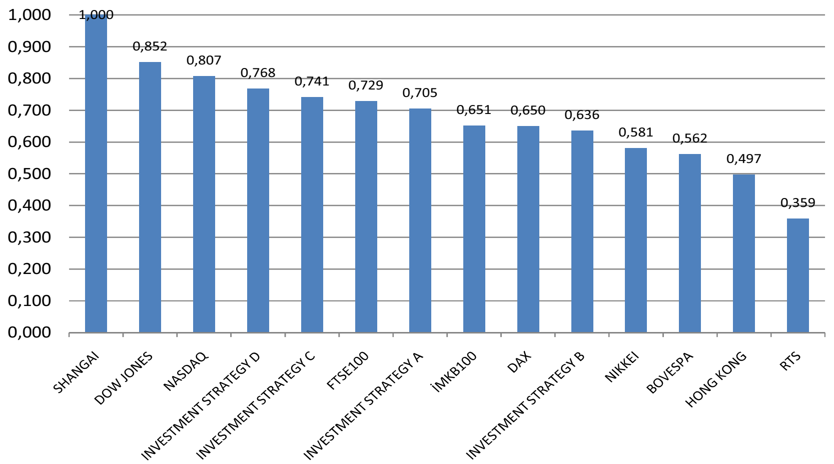



# 4. EFFICIENCY RESULTS OF STOCK MARKET AND ALNERNATIVE INVESTMENT STRATEGIES

Data Envelopment Analysis (DEA) is a nonparametric method in operations research and economics for the estimation of production frontiers. It is used to empirically measure productive efficiency of decision making units (or DMUs).

(Figure 6) According to the results which are obtained from BCC model (input oriented), the best undiversified investment strategy is Shangai Stock Market (China). Shangai stock market is reached 1.000 efficiency score (this score represents reference units for other DMUs). The main reason that Shangai stock market is selected as efficient frontier due to the lower standard deviation and higher mean return. The least efficient stock market is RTS Stock Market (Russia). RTS stock market reached 0,359 efficiency score because of the highest risk and the lowest mean return. On the other hand the best diversified investment strategy is D (Dow Jones, NASDAQ, FTSE 100 and DAX weighted equally of 25%) and the least efficient investment strategy is B (Shangai, Hong Kong, Bovespa, İMKB 100 and RTS weighted equally of 20%). This shows that developing countries investment strategies are negatively more affected from global financial crisis and serve less benefit to their investors than the other developed countries.

**Figure 6 :** BCC Model Efficiency Scores (September - December 2008)




As mentioned in the methodology section, the DEA results not only provide information on which DMUs outperform other DMUs included in the sample (and are therefore rated as fully efficient), but also which efficient stock market serve as benchmarks for inefficient DMUs. (Table 2) For find the radial distance between the efficient and inefficient DMUs, we use projection data obtained from DEA software. Projections results shows that the least efficient stock market RTS have to decrease standard deviation 64,10% and have to increase mean return 73,30% relative to the reference unit (Shangai Stock Index).

**Table 2 :** Ranking Technical Efficiency and Reference Sets for Inefficient DMUs

5.

| No. | DMU I/O | Score Data | Projection | Difference | % |
|---|---|---|---|---|---|
| 1 | SHANGAI | 1,000 | | | |
| | Std. Deviation | 5,88 | 5,88 | 0,00 | 0,00% |
| | Mean Return (%) | -1,22 | -1,22 | 0,00 | 0,00% |
| 2 | DOW JONES | 0,852 | | | |
| | Std. Deviation | 6,90 | 5,88 | -1,02 | -14,78% |
| | Mean Return (%) | -1,65 | -1,22 | 0,43 | 26,06% |
| 3 | NASDAQ | 0,807 | | | |
| | Std. Deviation | 7,29 | 5,88 | -1,41 | -19,34% |
| | Mean Return (%) | -2,44 | -1,22 | 1,22 | 50,00% |
| 4 | INVETSMENT STRATEGY D | 0,768 | | | |
| | Std. Deviation | 7,66 | 5,88 | -1,78 | -23,24% |
| | Mean Return (%) | -1,80 | -1,22 | 0,58 | 32,22% |
| 5 | INVETSMENT STRATEGY C | 0,741 | | | |
| | Std. Deviation | 7,94 | 5,88 | -2,06 | -25,95% |
| | Mean Return (%) | -1,81 | -1,22 | 0,59 | 32,60% |
| 6 | FTSE 100 | 0,729 | | | |
| | Std. Deviation | 8,07 | 5,88 | -2,19 | -27,14% |
| | Mean Return (%) | -1,48 | -1,22 | 0,26 | 17,57% |
| 7 | INVETSMENT STRATEGY A | 0,705 | | | |
| | Std. Deviation | 8,34 | 5,88 | -2,46 | -29,50% |
| | Mean Return (%) | -2,10 | -1,22 | 0,88 | 41,91% |
| 8 | İMKB100 | 0,650 | | | |
| | Std. Deviation | 9,04 | 5,88 | -3,16 | -34,96% |
| | Mean Return (%) | -2,36 | -1,22 | 1,14 | 48,31% |
| 9 | DAX | 0,651 | | | |
| | Std. Deviation | 9,03 | 5,88 | -3,15 | -34,88% |
| | Mean Return (%) | -1,63 | -1,22 | 0,41 | 25,15% |
| 10 | INVETSMENT STRATEGY B | 0,636 | | | |
| | Std. Deviation | 9,24 | 5,88 | -3,36 | -36,36% |
| | Mean Return (%) | -2,39 | -1,22 | 1,17 | 48,95% |
| 11 | NIKKEI | 0,581 | | | |
| | Std. Deviation | 10,12 | 5,88 | -4,24 | -41,90% |
| | Mean Return (%) | -1,87 | -1,22 | 0,65 | 34,76% |
| 12 | BOVESPA | 0,562 | | | |
| | Std. Deviation | 10,46 | 5,88 | -4,58 | -43,79% |
| | Mean Return (%) | -2,10 | -1,22 | 0,88 | 41,91% |
| 13 | HONG KONG | 0,497 | | | |
| | Std. Deviation | 11,82 | 5,88 | -5,94 | -50,25% |
| | Mean Return (%) | -1,71 | -1,22 | 0,49 | 28,66% |
| 14 | RTS | 0,359 | | | |
| | Std. Deviation | 16,38 | 5,88 | -10,50 | -64,10% |
| | Mean Return (%) | -4,57 | -1,22 | 3,35 | 73,30% |

# CONCLUSION

The global financial crisis impacts rapidly evolved and spread into a global shock resulting in a number of bank failures and declines in various stock indexes, and large reductions in the market value of equities (stock) and commodities worldwide. In this paper in order to determine the efficiency of stock market we use DEA model which can be a good tool measuring stock market efficiency during the global financial crisis.

DEA in its present form was first introduced in 1978, researchers in a number of fields have quickly recognized that it is an excellent and easily used methodology for modeling operational processes for performance evaluations. DEA's empirical orientation and the absence of a need for the numerous a priori assumptions that accompany other approaches (such as standard forms of statistical regression analysis) have resulted in its use in a number of studies involving efficient frontier estimation in the governmental and nonprofit sector, in the regulated sector, and in the private sector.

In the study we analyze ten major stock market indexes and four diversified stock market investment strategies during September - December 2008 using BCC input oriented model. Analysis result shows that the most efficient stock market is Shangai Stock Exchange. Shangai stock market is getting higher efficiency because of lower standard deviation and higher mean return. Hence the least efficient financial market is RTS Stock Exchange. Projections score is relative to the best frontier, RTS Stock Exchange have to decrease standard deviation 64,10% and increase mean return 73,30%.

Furthermore in a given time period the best diversified stock index investment strategy is Investment Strategy D (Dow Jones, NASDAQ, FTSE 100 and DAX weighted equally of 25%). The least efficient stock index investment strategy is Investment Strategy B (Shangai, Hong Kong, Bovespa, İMKB 100 and RTS weighted equally of 20%). This result shows that developed stock markets is serve better performance to their investors in a given time period.

# APPENDIX

**Appendix:** Stock Markets Weekly Data

| | 1)İMKB100 | 2)DOW JONES | 3)NASDAQ | 4)BOVESPA | 5)DAX |
|---|---|---|---|---|---|
| 05.Sep | -1,83 | -3,66 | -4,73 | -6,72 | -4,59 |
| 12.Sep | -5,32 | 2,71 | 0,22 | 0,87 | 1,76 |
| 19.Sep | -1,79 | -0,30 | 0,57 | 1,26 | -0,72 |
| 26.Sep | 0,51 | -2,15 | -4,00 | -4,11 | -2,04 |
| 03.Oct | -5,48 | -7,34 | -10,81 | -12,49 | -4,40 |
| 10.Oct | -17,53 | -18,15 | -15,25 | -20,01 | -21,79 |
| 17.Oct | -9,22 | 4,75 | 3,70 | 2,22 | 5,45 |
| 24.Oct | -6,54 | -5,34 | -9,29 | -13,51 | -10,14 |
| 31.Oct | 15,12 | 11,29 | 10,89 | 18,34 | 16,11 |
| 07.Nov | -4,26 | -4,09 | -4,30 | -1,59 | -1,00 |
| 14.Nov | -4,59 | -5,00 | -7,89 | -2,44 | -4,62 |
| 21.Nov | -13,60 | -5,31 | -8,77 | -12,67 | -12,38 |
| 28.Nov | 17,07 | 9,73 | 10,98 | 17,15 | 13,13 |
| 12.Dec | -6,53 | -2,27 | 0,20 | 7,59 | -0,13 |
| 19.Dec | 5,09 | -0,58 | 1,62 | -0,61 | 0,73 |
| 26.Dec | 1,12 | -0,74 | -2,16 | -6,80 | -1,44 |
| **Mean Return (%)** | ***-2,36*** | ***-1,65*** | ***-2,44*** | ***-2,10*** | ***-1,63*** |
| ***Std. Deviation*** | ***9,04*** | ***6,90*** | ***7,29*** | ***10,46*** | ***9,03*** |
| | | | | | |
| | ***6)FTSE100*** | ***7) RTS*** | ***8)NIKKEI*** | ***9)SHANGHAI*** | ***10)HONG KONG*** |
| 05.Sep | -7,03 | -10,75 | -1,64 | -6,10 | -0,97 |
| 12.Sep | 3,36 | -8,65 | -3,24 | -4,24 | -6,53 |
| 19.Sep | -1,96 | -3,43 | -1,02 | 6,73 | 1,25 |
| 26.Sep | -4,18 | -0,85 | -2,48 | 3,33 | -6,67 |
| 03.Oct | -2,14 | -16,65 | -11,18 | -4,80 | -6,55 |
| 10.Oct | -20,72 | -21,10 | -20,98 | -7,55 | -10,61 |
| 17.Oct | 2,91 | -20,95 | 7,71 | -5,05 | -0,59 |
| 24.Oct | -4,43 | -17,81 | -19,64 | -10,12 | -25,31 |
| 31.Oct | 12,72 | 46,08 | 19,74 | 0,17 | 29,67 |
| 07.Nov | -0,27 | -5,11 | 5,88 | 6,32 | 0,12 |
| 14.Nov | -3,02 | -15,37 | -6,14 | 9,70 | -7,66 |
| 21.Nov | -10,68 | -9,94 | -7,18 | -4,12 | -8,02 |
| 28.Nov | 13,41 | 13,45 | 6,14 | -2,59 | 13,41 |
| 12.Dec | -0,30 | -0,91 | 3,18 | 3,51 | 7,23 |
| 19.Dec | 0,28 | -2,76 | 0,69 | 2,16 | -3,87 |
| 26.Dec | -1,64 | 1,65 | 0,26 | -6,94 | -2,26 |
| **Mean Return (%)** | ***-1,48*** | ***-4,57*** | ***-1,87*** | ***-1,22*** | ***-1,71*** |
| ***Std. Deviation*** | ***8,07*** | ***16,38*** | ***10,12*** | ***5,88*** | ***11,82*** |

# REFERENCES


Banker R.D., Charnes A. and Cooper W.W., (1984). Some Models for Estimating Technical and Scale Inefficiencies in Data Envelopment Analysis. Management Science, 30(9), 1078-1092

Bloomberg World Market Cap Data, http://seekingalpha.com/article/99256-world-equity-market-declines-25-9-trillion

Charnes A., Cooper W.W. and Rhodes, E. (1978), "Measuring Efficiency of Decision Making Units", European Journal of Operational Research, 2(6), 429-444

Charnes A., Cooper W.W. and Rhodes E. (1981). Evaluating Program and Managerial Efficiency: An Application of Data Envelopment Analysis to Program Follow Through, Management Science, 27(6), 668-697

Eling M. (2006), Performance Measurement of Hedge Funds Using Data Envelopment Analysis, Working Paper Series in Finance, Paper No.31, 1-34

Gregoriou G. N. and Zhu J., Evaluating Hedge Fund and CTA Performance: Data Envelopment Analysis Approach, John Wiley & Sons; Har/Cdr edition, 1-167

ISE (http://www.ise.org/data.htm)

Joro T. (1998), Models for Identifying Target Units in Data Envelopment Analysis: Comparison and Extension, International Institute for Applied Systems Analysis, Working Paper, 1-14

Lopes et al. (2008), "DEA Investment Strategy in The Brazilian Stock Market." Economics Bulletin, 13(2), 1-10

Ray S .C. (2004), Data Envelopment Analysis, The University of Cambridge Press, USA, 1-339

Reuters (http://www.reuters.com/finance/markets)

Soteriou J. A. and Zenios S. A (1999), Using Data Envelopment Analysis for Costing Bank Products, European Journal of Operational Research, 114(2), 234-248

Tam F.K. (2001), A Study of the Relative Stock Market Pricing Efficiency in Several Industries, Using Data Envelopment Analysis, Master's of Applied Science, Graduate Department of Mechanical and Industrial Engineering University of Toronto, 1-115

Tavares G. (2002), A Bibliography of Data Envelopment Analysis (1978-2001), Rutcor Research Report, RRR 01-2002, 1-183

# PENSION FUNDS AND WORLD FINANCIAL CRISIS IN THE OECD COUNTRIES

**Sudi Apak**
**Beykent University, Turkey**

**Kamer Hagop Taşcıyan**
**Kadir Has University, Turkey**

## ABSTRACT

*A pension fund is a pool of assets that are bought with the contributions to a pension plan for the exclusive purpose of financing pension plan benefits. Pension funds especially important for financial markets as an institutional investor. The largest 300 pension funds collectively hold about $ 6 trillion assets. In January 2008, Morgan Stanley estimates that pension funds world-wide hold over $ 20 trillion assets.*

*The ongoing global financial crisis has dealt a heavy blow to pension systems. Between January -October 2008, private pensions in the OECD area have registered losses of nearly 20 percent of their assets. Furthermore financial crisis has negative effects on financing of pension plans. Funding levels in defined benefit plans are down by more than 10 percent on average, creating a funding gap at the end of October 2008 as high as $ 2 trillion. Older members of defined contribution plans have also experienced large losses and risk having much lower income at retirement.*

*In this study we investigate global financial crisis and its effects over the pension funds. As a result, pension funds' short-term impacts are evidently negative, but their long term maturities and performances are stil positive.*

***Keywords:*** *Global financial crisis, pension funds, performance, maturity, pension participants*

## INTRODUCTION

A pension fund is an legal entity set up to collect contributions from employer(s) and workers or any individuals, invest the proceeds in securities and other assets, and pay benefits to retirees from the fund's accumulated resources. A pension fund ordinarily has an investment policy statement that describes the nature of the assets in which the pension fund can invest. Traditionally, the investment plan of a pension fund has been quite conservative, sometimes limiting its invetsment vehicles to government bonds or life insurance annuities. In recent decades, the average pension fund has assumed a more aggressive investment posture to achieve the higher returns required by its obligations (Investor Glossary http://www.investorglossary.com/pension-fund.htm). Furthermore the credit crunch and the recent collapse in share prices have rightly made people worried about for their future pension. Pension funds lost threatening severe hardship for many people in their old.

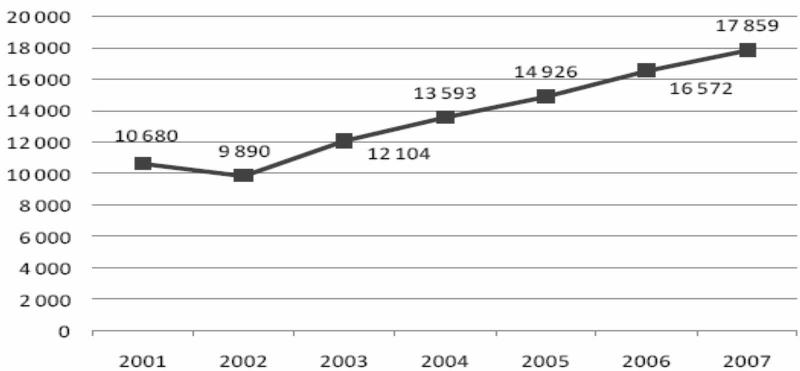
In this study we investigate the ongoing financial crisis and the impacts over pension fund performances in selected OECD countries. So we organize the papers as follows, Section 1 introduces pension market overview. Section 2 explains pension fund performances in OECD countries in a short and long time horizon. Section 3 describes the biggest pension markets and Turkish pension markets during global financial crisis.

# 1. PENSION MARKET OVERVIEW

OECD pension fund assets reached USD 17.9 trillion in 2007, which represents about 64% of the total assets in private pension arrangements. In absolute terms, the United States has the largest pension fund market, with assets worth USD 10.2 trillion. However, its share of the OECD total pension fund assets has shrunk by 10% since 2001 as a result of faster growth among pension funds in other OECD countries.

Total pension fund assets in the OECD area grew by 67% between 2001-2007, or 9% annually. Growth was relatively stable over the years, apart from the drop in 2001-2 caused by negative equity performance (see Figure 1).

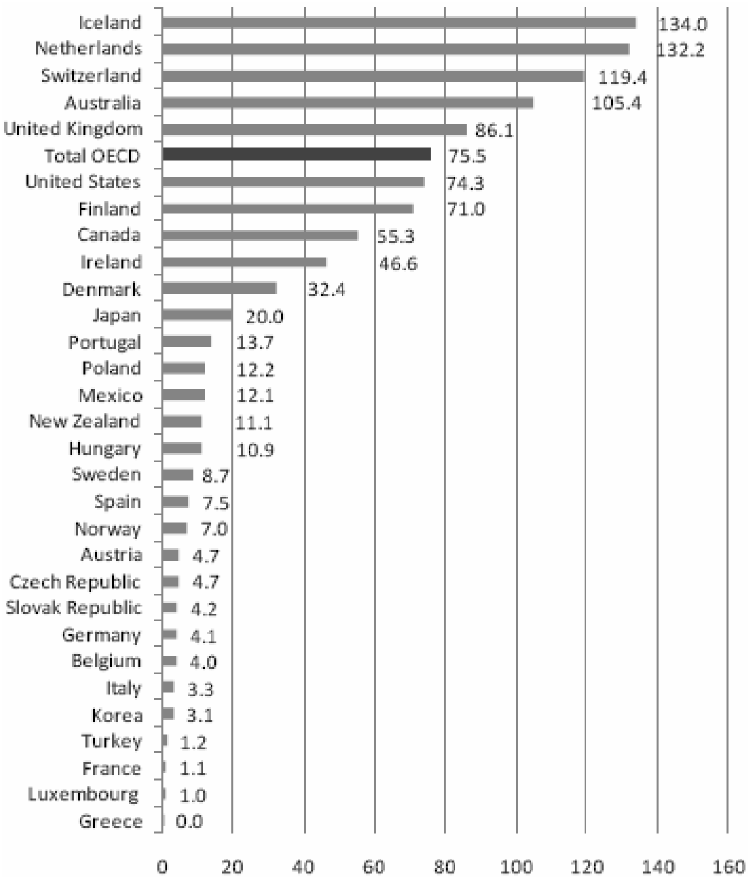
**Figure 1.** Trends in total OECD pension funds assets, 2001-2007 (USD billion)




**Source:** OECD, 2008

The OECD weighted average asset-to-GDP ratio for pension funds increased from 67.3% of GDP in 2001 to 75.5% of GDP in 2007, with Iceland achieving the largest ratio in 2007, at 134%. As Figure 2 shows, in 2007, only four OECD countries achieved asset-to-GDP ratios higher than 100% – Iceland (134%), the Netherlands (132%), Switzerland (119%) and Australia (105%). In addition to these countries, the United Kingdom exceeded the OECD weighted average asset-to-GDP ratio of 75.5%. Pension fund assets were of varying importance relative to GDP in the other countries. Only elevenout of thirty countries had assets-to-GDP ratios above 20%, which is considered the minimum for meeting the OECD's definition of a "mature" pension fund market.

**Figure 2.** Importance of pension funds relative to the size of the economy in OECD countries, 2007 (As a percentage of GDP)



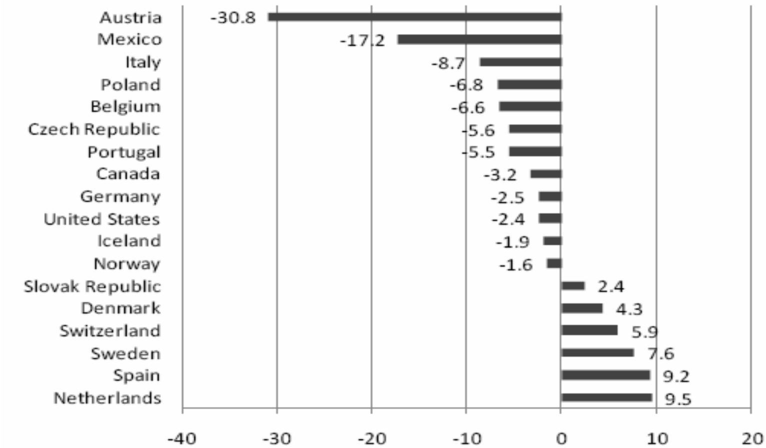

**Source:** OECD, 2008

In most OECD countries bonds and equities remain the two most important asset classes, accounting for over 80% of total portfolios in 2007. Proportions of equities and bonds vary considerably across countries. Although there is, in general, a greater preference for bonds, the reverse is true in some OECD countries, namely Belgium, where equities outweigh bonds by 48% to 21.5%; Canada by 50% to 34.4%; Germany by 31.3% to 28.8%; and the United States by 59.2% to 22.4%. A rise in the proportion of cash and similar assets (e.g. money market instruments) was observed in 2006-7. Between 2001 and 2007 investment in equities in the OECD area decreased by 2.1%, while investment in bonds increased slightly by 0.3%.

In some OECD countries, on the other hand, pension funds either reduced their equity allocations (e.g. Denmark, the Netherlands, and Switzerland), or increased them only marginally (e.g. Spain and Sweden), while increasing their bond allocations substantially, as shown in Figures 3 and 4. Given the strong performance of equities over bonds in all these countries, pension funds in these countries engaged in a major rebalancing of their portfolio from equities to bonds. A bigger and broader shift towards bonds and cash is expected in 2008.

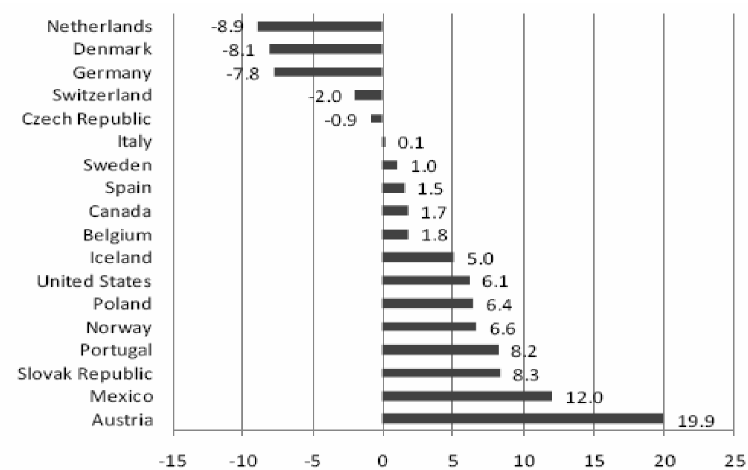
Pension funds have also increased their diversification in foreign markets in recent years. Over 2001-2007, pension funds based in the euro area benefited from the elimination of currency risks, leading to greater international diversification in pension fund portfolios. Of the OECD sample surveyed, the Netherlands has the most internationally diversified pension fund portfolio, with 82% of total assets issued by entities located overseas and nearly 40% in currencies other than the euro.

**Figure 3.** Variations in bills and bonds allocations between 2001 and 2007 in selected OECD countries




**Source:** OECD, 2008

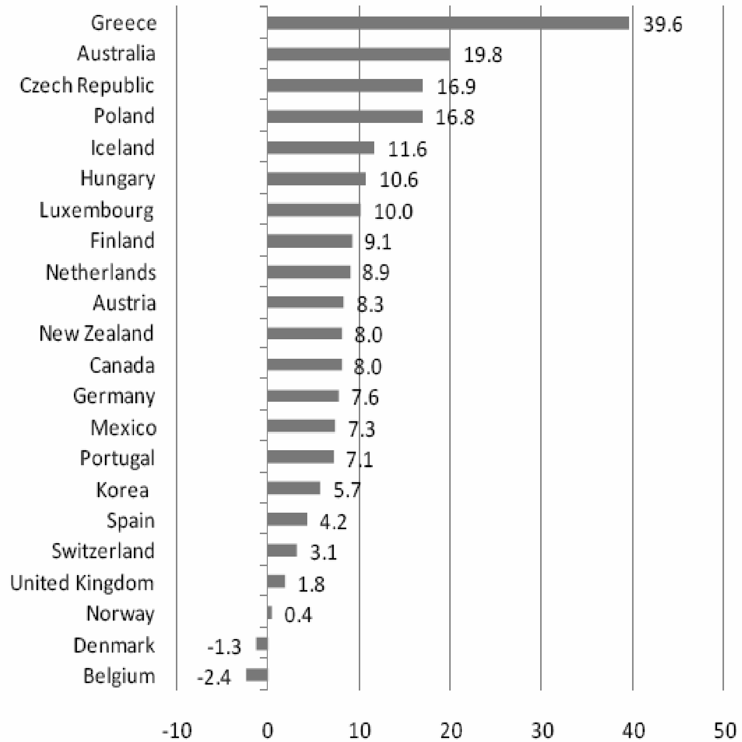
**Figure 4.** Variations in equities allocations between 2001 and 2007 in selected OECD countries




**Source:** OECD, 2008

All OECD countries for which data were available, except for Belgium and Denmark, showed positive net income flows in 2007 (see Figure 5). 2007 was nevertheless substantially worse than the previous year, as net income was positive in all countries in 2006 and was generally higher. The negative income in Belgium and especially Denmark may have been exacerbated by equity sales. As equity markets crashed in 2008, many more countries are expected to have negative pension fund income (OECD, 2008).

**Figure 5.** Pension funds' net income for selected OECD countries, 2007 (As a percentage of total assets)




**Source:** OECD, 2008

# 2. PENSION FUND PERFORMANCE IN OECD COUNTRIES

The investment process of pension funds is strategically important as well as the fund performance for beneficiaries, retirement corporations and regulatory authorities. The analyses of these data are an important clue for the potential number of beneficiaries and the effectiveness of pension fund investments (Altınbaş, 2008).

## 2.1. Pension Fund Short-Term Performance

(See Figure 6) Stock markets have fallen by nearly half from the start of the year to October 2008. The crash in equity markets has hit private pension systems, leading to large investment losses and weaker funding levels.

**Figure 6**. Major Stock Market Performance


**Source:** Thomson Financial Data stream, 2008, http://www.datastream.com/

Pension funds have experienced a negative return of nearly 20% in nominal terms (22% in real terms) on average since the beginning of the year (see Table 1). Most of the loss is accounted for by pension funds in the United States (USD 2.2 trillion out of the total OECD loss of 3.3 trillion) as they account for more than half of all OECD countries pension fund assets and had the second worst investment performance. Only four other OECD countries saw pension fund returns worse than minus 20% in nominal terms. In absolute terms, the second largest loss was the United Kingdom is (USD 0.3 trillion), followed by Australia is (USD 0.2 trillion). Investment losses on all OECD private pension plans (including individual retirement accounts and pension insurance contracts) are estimated at USD 5 trillion, 3.3 trillion of which in the United States alone. These losses, though substantial, are smaller than the decline in equity values. Pension funds have benefited from having diversified investment portfolios, often with a large proportion invested in bonds, whose rates of return are lower but more stable than those of equities. In December 2007, in 13 out of 22 OECD countries for which information was available, over 50% of assets were invested in bonds, and around 60% of these investments were in government bonds (OECD, 2008).

**Table 1.** Nominal and real pension fund returns (%) in selected OECD countries January-October 2008

| Country | Real | Nominal |
|---|---|---|
| Ireland | -33,4 | -30,0 |
| United States | -25,8 | -21,5 |
| Iceland | -25,2 | -14,4 |
| Hungary | -25,0 | -20,0 |
| Australia | -24,4 | -20,3 |
| Canada | -23,9 | -21,0 |
| OECD average | -22,7 | -18,9 |
| Poland | -20,9 | -17,3 |
| Japan | -19,4 | -17,6 |
| Netherlands | -18,7 | -16,1 |
| Belgium | -17,9 | -13,4 |
| United Kingdom | -17,2 | -13,3 |
| Norway | -17,1 | -13,5 |
| Finland | -16,0 | -12,0 |
| Switzerland | -12,6 | -10,2 |
| Portugal | -12,4 | -9,7 |
| Austria | -11,7 | -8,4 |
| Sweden | -11,2 | -7,4 |
| Spain | -10,8 | -6,6 |
| Denmark | -10,5 | -7,0 |
| Germany | -10,1 | -7,1 |
| Mexico | -10,0 | -5,0 |
| Slovak Republic | -9,7 | -5,2 |
| Italy | -9,5 | -5,6 |
| Turkey | -7,6 | 2,5 |
| Korea | -2,5 | 3,3 |
| Czech Republic | -4,8 | 1,9 |
| Greece | -4,7 | -0,6 |

**Source:** OECD, 2008

The impact of the crisis on investment returns has been greatest among pension funds in countries where equities represent over a third of total assets invested, with Ireland the worst hit at -30% in nominal terms. Irish pension funds were the most exposed to equities, at 66% of total assets on average, followed by the United States, the United Kingdom, and Australia.

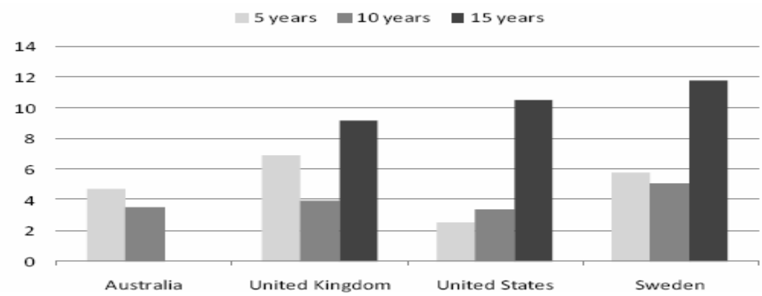
The full impact on investment returns, however, will only be revealed when the annual reports for 2008 are submitted by pension funds to their supervisory authorities. In particular, there is a lack of clarity over the valuation of some liquid assets – those that cannot be turned into cash quickly – such as real estate or so-called structured products (that combine a periodic payment at a predetermined rate and another component, often the option to buy or sell an asset at some time in the future). Direct exposure to the "toxic" part of structured products and asset-backed securities may be as high as 3% of assets under management for the pension fund industry as a whole. However, allocations differ across countries and between funds, with some likely to face much greater losses than others (OECD, 2008).

## 2.2. Pension Fund Long-Term Performance

Although the short-term impact is evidently negative, pension funds, by their very nature, have to work with a long time horizon and their performance should also be evaluated on this basis.

Previous experience of similar situations may be helpful in this regard. The decline in equity returns over 2000-02 was just as serious as in 2008, though the latest one has been much faster. Despite the severity and proximity of these two market downturns pension funds have had a positive performance over the last ten years and a rather healthy one over the last fifteen years, up to October 2008 (see Figure 7). For example, the average, annual nominal rate of return of pension funds over the least fifteen years was 11.8% in Sweden (8.5% in real terms), 10.6% in the United-States (6.1% in real terms) and 9.2% in the United Kingdom (6.1% in real terms). Focusing on a single year□s return gives a misleading picture of the ability of pension funds to deliver adequate pensions in old-age. Pension funds also have very small liquidity needs in relation to their total assets under management. This means that they do not need to sell assets at current low prices to meet benefit payments and other expenditures as they can rely on the regular flow of contributions and investment income, even if the latter is reduced. The main exception is defined benefit plans with frozen accruals. These plans rely largely on running down their assets to meet benefit payouts, so when asset values decline sharply, they cannot wait until the market recovers to sell and may have to sell at a loss. This is the case of many plans in the United Kingdom and increasingly in the United States.

**Figure 7.** Nominal average annual pension fund returns (%) in selected OECD countries over the last 5, 10 and 15 years




**Source:** OECD, 2008

The longer-term outlook depends of course on what happens in the markets. Optimists could argue that the much faster drop in values compared to 2000-02 is a result of closer links in the financial system and that recovery could be rapid. Pessimists could point out that the previous crash was not followed by a major credit crunch and a deep recession across the developed economies as is the case today.

Whatever happens, if poor financial market performance continues, pension funds' ability to meet future obligations could be harmed. The effect could be important if, over several years, the real rate of return on a funds investments remained significantly below the fund' long-term targets (OECD, 2008).

## 3. BIGGEST PENSION FUND MARKET AND TURKEY

The objective for any pension scheme must be to fund the continuation of living standards (appropriately adjusted) available prior to retirement at an acceptable cost. Losses in equities markets directly affected pension markets and retirement benefit and cost in a short period. Due to the credit crunch and the recent collapse in share prices have rightly made people worried about their pension (Arthur and Taylor, 2008).

(See Table 2) In absolute terms, the United States had the largest pension fund market in the OECD with assets worth USD 9.7 trillion – approximately two thirds of the total OECD aggregate market. The US share of OECD pension fund assets, however, has shrunk from a level of 68% in 2001 to 60% in 2006. Apart from the United States, other OECD countries with large pension fund systems include the United Kingdom (USD 1.8 trillion), Japan (USD 1.0 trillion), the Netherlands (USD 860 billion), Australia (USD 690 billion) and Turkey (USD 4 billion).

**Table 2.** The Five Biggest Pension Markets and Turkey (Total Investment in Pension Funds)

| OECD Countries | Situation of Pension Markets | Total Invetsment (2006) |
|---|---|---|
| **1)U.S** | Developed | USD 9.7 Trillion |
| **2)U.K** | Developed | USD 1.8 Trillion |
| **3)Japan** | Developed | USD 1.0 Trillion |
| **4)Netherlands** | Developed | USD 860 Billion |
| **5)Australia** | Developed | USD 690 Billion |
| **Turkey** | Developing (Started at 2003) | USD 4 Billion |

**Source:** OECD, 2007

## 3.1. U.S Pension Market

The U.S. government agency that guarantees pensions (PBGC) has lost USD 2.1 billion on its investments so far 2008, foreshadowing expected losses among corporate pension funds, state retirement systems and others that provide a financial backstop for an aging population (Walsh, 2008).

Retirement plans lost close to 30% of their value in 2008, according to the Federal Reserve's Flow of Funds report. But the government's own retirement plan grew 2%, largely because most of the assets are invested in non-marketable U.S fixed-income securities, rather than equities.

The plunge in equities had a major impact on assets of both defined benefit and defined contribution plans. Total assets in all corporate defined benefit and defined contribution plans as of Dec. 08 were USD 4.6 trillion, down 28% from the end of the previous year. Total assets in corporate defined benefit plans were USD 1.93 trillion, down 27.6%. Total assets in corporate defined contribution plans were USD 2.66 trillion, down 28.5% from year-end 2007. Corporate DB plans had USD 771 billion in equities at the end of 2008, a 46.5% decline for the year. Corporate DC plans had USD 877 billion in equities, down 37.2%. That equity in defined benefit plans declined more sharply than in defined contribution plans is not related to performance but to larger benefit payments being paid out of the DB plans. (Pionline, http://www.pionline.com/apps/pbcs.dll/article?AID=/20090323/PRINTSUB/3032399 75/1072/DataStore)

## 3.2. U.K. Pension Market

The UK three-pillar system of pension and retirement income has been touted as a way forward for failing continental European pay-as-you-go social security systems. A minimum state-provided pension combined with a generous occupational pension and individual savings was seen by many as a way of simultaneously managing future nation-state liabilities while encouraging individuals through their employer or on their own account to make provision for their income aspirations (Clark, 2008, http://www.geog.ox.ac.uk/news/events/phclcs/Clark.pdf).

The financial market crisis has seen the value of employee-contributed pensions in the UK plummet by as much as £157 billion over the past year, according to a study released by Aon Consulting. The value of defined contribution pension assets, contributed by around 3.7 million workers and worth over £552 billion in October 2007, has dropped to around £395 billion by October 2008 – a decline of 28 per cent in one year (AON, http//aon.mediaroom.com/file.php/338/102708+UK+Pensions .pdf). This works out to a £46,417 loss for each of the 3.4 million workers who pay into such schemes, although amounts will vary according to contributions and investments made. This means that those who are part of a defined contribution pensions scheme and are close to retirement may now have to work longer to recover the losses suffered in the market meltdown.

This brings to focus the real effects of the financial market crisis and the consequent economic downturn on the money that workers putting aside as savings. Most major UK companies have switched over to the defined contribution scheme over the past decade, after closing their final salary schemes to new employees. Experts regard defined contribution plans as less effective for workers because participants bear the brunt of the investment risk and it is also difficult to build a fund for those who enter late in life (Domain-b, http://www.domainb.com/investments/world_markets/ 20081027_funds.html).

## 3.3. Japanese Pension Market

Japanese corporate pension funds lost a record percent (-19,4 nominal and -17,6 real return) on their investments in the year that ended September 2008 due to a rise in the yen and falls in share prices as the financial crisis.

The yen dropped to around 100 yen to the dollar in March after surging to a 13-½ year high in January. A stronger yen usually pushes down the value of foreign currency-denominated securities held by pension funds. alls in share prices also likely hurt their performance. On the other hand Japanese pension funds' poor performance partly reflects the sharp drop in Japan's equity market and historically low bond yields. Ever since the bank of Japan introduced its zero-interest rate policy in 1999, fund managers have also been particularly attracted to more leveraged investments (XE, http://www.xe.com/news/2009-04-03%2001:23:00.0/340225.htm?categoryId=1&currentPage=1).

## 3.4. Netherlands Pension Market

Pension funds in the Netherlands have been hard hit by the financial crisis. The level of cover of several pension funds has sunk below the obligatory 105 percent.

The four largest funds have announced the biggest losses, namely, ABP (civil servants and teachers), Zorg & Welzijn (health sector), Metalektro and Metaal & Techniek. ABP lost 39 percent of its value last year, and Metalektro lost nearly 46 percent. Zorg and Welzijn, covering the health sector, is asking politicians in The Hague for a three-year recovery time. Their level of cover fell from 126 percent to 92 percent in the fourth quarter. As a result premiums for these pensions will be increased while pension payments are lowered. Around 2.1 million people pay into this pension fund, which has lost 16 billion euros in the financial crisis.

Most pension funds have scrapped price indexing. This effects both the retired, and the working. Declining interest rates in the forth quarter last year account for a high percentage of the funds decreased value. Low interest rates spell higher premiums, which is passed on to working people. (Expactica, http://www.expatica.com/fr/news/local_news/Pensions-in-the-Netherlands-hard-hit-by-crisis_49119.html)

## 3.5. Australian Pension Market

Plunge in financial markets has wiped out around a quarter of Australia's near-USD 1 trillion in pension-fund savings in real terms, according to OECD data, a figure surpassed only by the vastly bigger economies of the United States and Britain. Australian pension funds lost about USD 200 billion in the first 10 months of 2008, compared with USD 300 billion for the UK and a staggering U.S. loss of USD 2.2 trillion, the data showed. Over 10 years, Australian data still shows positive returns but even local industry figures point to the worst decade in 30 years. The staggering loss is a direct consequence of the global credit crisis which has had the result of devaluing assets globally (Mail and Guardian, http://www.mg.co.za/article/2009-01-27-australians-pension-funds-trashed)

## 3.6. Turkish Pension Market

As the crisis set in, the fund range offered by Turkish pension insurance firms has become more conservative. Whereas in September 2008 some 67 percent of all funds were invested in Treasury bills and bonds, the figure reached 71.3 percent by end-January. In the same period, the ratio of equity funds dropped from 7.7 percent of all funds to 7.5 percent. Investments in reverse repossession have also decreased, from 19.9 percent in September to 16.1 percent in January. At present, the remaining 5.1 percent of the funds is invested in other asset classes, according to Turkey's Capital Markets Board, or SPK. Invest conservatively, allocating a substantial portion of their pension funds into high quality government bonds, keeping the share of equities below 10%, prevent Turkish pension system from bigger losses.

## CONCLUSIONS

Institutional investors are becoming more important in global financial markets, with their assets under management rapidly catching up with those of the banking system. Institutional investors help to ensure deeper and better functioning markets.

Pension fund is the one of the biggest example of institionial investors which held and manage pension assets in global financial markets. According to OECD figures, as of October 2008, the total assets of OECD-based pension funds had declined by over USD 3.3 trillion, or about 20% in real terms since December 2007, as a result of the deepening global financial crisis. If one adds individual retirement accounts in the United States (the "401(k)" plans) and other countries, this figure increases to about USD 5 trillion. The impact of the crisis is most severe in Ireland, the US, the UK, Canada, the Netherlands, Australia, and Japan, all of which have sizeable pre-funded pension sectors, with total assets under management representing over 50% of national GDP. Although some countries such as Australia, U.K., U.S., Sweden pension funds long term performance (5-10-15 years) are still positive.

On the other hand the ongoing financial crisis is less affected where the countries prefer to invest more traditional assets such as treasury bills and goverment bonds. OECD reports shows that in some OECD countries (Turkey, Greece, Korea, Czech Republic, Greece) pension fund nominal and real performance is better than the other OECD countries due to the invested more secure financial vehicles.

## REFERENCES


Altınbaş K. M. (2008), The Risk-Based Management Performance Evaluation of Turkish Private Pension Funds: An Analysis For 2004-2006 Period, Anadolu University Journal of Social Sciences, 8(1), p.85-110

AON, News From Aon, October 2008, http//aon.mediaroom.com/file.php/338/102708+UK+ Pensions.pdf

Clark G. L. (2006), The UK Occupational Pension System in Crisis, Oxford University Press, http: //www.geog.ox.ac.uk/news/events/phclcs/Clark.pdf

Domain-b, http://www.domainb.com/investments/world_markets/20081027_ funds.html

Expactica, http://www.expatica.com/fr/news/local_news/Pensions-in-the-Netherlands-hard-hit-by-crisis _ 49119.html

Investor Glossary, http://www.investorglossary.com/pension-fund.htm

Mail and Guardian, http://www.mg.co.za/article/2009-01-27-australians-pension-funds-trashed

OECD (2008), Pension Market in Focus, Issue 5, p.1-20

OECD (2007), Pension Market in Focus, Issue.4, p.1-24

Pionline, http://www.pionline.com/apps/pbcs.dll/article?AID=/20090323/PRINTSUB/3032399 75/1072 /DataStore

Thomson Financial Data stream, http://www.datastream.com/

Walsh M. W. (2008), U.S. Pension Insurer Lost Billions in Market, http://revolutionradio.Org/ 2008/ 10/23/us-pension-insurer-lost-billions-in-market/

XE, http://www.xe.com/news/2009-04-03%2001:23:00.0/340225.htm?ca tegoryId=1&current Page =1

# EXPLANATION OF INTERACTION OF THE ASSETS OF ORGANIZATIONS WHICH ARE DETERMINANT IN THE SURVIVAL AND GROWTH OF THEM

**Ali Sayilir**
**Serkan Dirlik**
**Muğla University**

## ABSTRACT

*The study suggests a dynamic model which explains the important factors affecting the success of a business at start up, at growth stage and at sustaining its position. Entrepreneurship quality, experience and education related to a business, and ability develop business and social relations are suggested to lead success in a business at start up. A visionary professional management approach is said to be a key to the growth of a business. To the model Sustaining of a business position depends on ability to reach a satisfying market share and maintenance of ability of competitiveness. To verify the model, a multiple case research conducted related to the first 1000 industrial companies of Turkey. The sample contains 10 successful companies and one unsuccessful cases from the list of the 1000 companies. Even though the sample representiveness was not adequate, the factors, except entrepreneurship quality, that are said to be determinant of the success of a business at start up are verified by 7 cases of the sample. There is not any sign of a visionary professional management approach effect on the success of 8 cases. Sustaining position seems to be related to renovation efforts pertained to machinery and facilities.*

## INTRODUCTION

The main purpose of this study is to highlight the evolution process of the organization's assets. In today's world, evolution of various assets of a country is affected by the capacities of the existing organizations. The countries which can generate organizations that are able to compete at international level locate themselves in forefront with regards to economy. Explanation of the evolution of the organizations that can compete in global arena; that is, the explanation of the development and interaction of the assets of organizations can contribute to the field of organization and management; in particular, to the field of strategic management. Identifying the topography of the path which begins with a founder of an organization and continues with institutionalization of the organization, its growth and development will help us to understand how human resources and social relations develop, how capital and physical resources accrue in the organization, and what are the characteristics of the entrepreneur who will make all these possible. In this respect, the purpose of the study is to put forth the differentiating characteristics of the successful entrepreneurs, to determine the functions of these characteristics in the institutionalization and growth of the organization, to highlight the ways followed by the founder or founders to foster the social relations, to investigate technology accumulation and its relation to the other resources, to contribute to the findings in this field with respect to Turkey, to demonstrate the sector-specific differences, and to make up a preliminary study for the further studies to be conducted on Turkey.

## LITERATURE REVIEW

Penrose (1959) define the organization as a combination of productive resources which make it possible to produce the structures and services which create growth and development opportunities. The approach adopted by Penrose inspired the resource-based notion stated by Wernerfelt (1984). The subject was later dealt with by many authors (Rumelt, 1984; Barney 1986; Prahalad and Hamel 1990; Hamel 1991Grant 1991; Peteraf 1993; Amid and Schoemaker 1993). Resource-based approach starts with the classification of organization' resources, and usually classifies them as non-physical (human resources or social resources), physical and monetary resources. Such a classification is claimed to be useful in the explanation of the process of entrepreneurship (Brush and Greene, 1996; Greene and Brown, 1997). Classification of the resources in that way enables us to understand their relations with each other, to demonstrate their relations with the founder or founders and to analyze their relations with the external factors (Greene, Brush, and Brown, 1997).

Founder(s) of an organization use(s) their abilities and social connections to obtain the monetary and physical resources required to found the organization. (Hart, 1995; Hart, Greene and Brush, 1997). The quality and the characteristics of the founder play a significant role in the success of the organization. The characteristics or abilities of the founder include elements such as his judgment, intuition, creativity, intelligence, ability to recognize the opportunities, values and beliefs (Dollinger, 1995). In the initial phase, these characteristics are determinant; especially; in the success (Brush and Greene,1996; Greene and Brown 1997), and have the central role in the realization of any opportunity and successful establishment of the organization (Stevenson and Gumpert, 1985).

Social relations, on the other hand, include the resources made available to the organization by means of the relations web established both by individuals and groups either consciously or unconsciously (Bourdieu 1983; Coleman 1988). These relations can be formed as a result of past patterns of establishing relations either within the family or other circles (Grene and Brown; 1997). Social capital or relations web is a mean to be capitalized to have access to the other resources or to extend these relations. An outcome of this relations web which allows resource or information exchange is its generating trust among those involved (Fukuyama 1996).

As known, physical assets consist of elements such as raw materials, land, factory building, stationery, fixture, and vehicles that are brought together to produce goods or services. Initially, these resources are generally limited. However needed initial physical and monetary resources may differ from one sector to another, and the accumulation and development of these resources depend on the success achieved by the organization throughout its life span. Another issue varying greatly is the initial combination of the resources used to start the business, and these variations may result in unique identity and structure in each organization. Changing the initial structure which is to a great extent founder-bounded can usually be possible either as a result of the pressure created by environmental factors or founder’s giving up the active management or changing himself.

Monetary and other similar resources make it possible to have access to physical resources and human resources. Initially, these resources are limited to personal resources of the founder and to those that can be reached by means of personal relations of the founder (Shulman). Resources that are obtained from the media such as banks and capital markets are not open to the use of the organization at the beginning due to the smallness of the organization, lack of past records, and uncertainties related to the future success of the organization (Stinchcombe 1965; Aldrich and Auster 1986). Since initial capital considerably affects an organization success, the issue is more difficult to deal with at the beginning (Bruno and Tyebjee 1982). Accordingly, the possibility of the organization’ standing on its feet basically depends on the monetary resources owned by the founder and the monetary and human resources that can be reached through the founder’s social relations.

Both the initial stage, growth and the survival of the organization are the main concerns of the resource-based approach. In the studies conducted in this field, although the classification of the resources and drawing frameworks for them have sufficiently been dealt with, formation process of the basic resources of the organization hasn’t been adequately studied and empirically tested. As this study tries to highlight which elements give life to the founder or a group of founders, how these subsequently affect the accumulation of the physical, social and monetary resources, how the interaction takes place among these resources, and how they breed each other with reference to the organizations from Turkey. Its content consists of the formation of the organization, their survival, and their growth.

Demonstration of the factors which are influential in the survival and growth of the organization are the topics that have been examined the most extensively by researchers of management and organization, especially, by those of strategic management. Strategic management approach blossoming during 1960s (Higgins 1994) basically concentrates on the simplification of the investment fields increasing in number. The years preceding 1960 witnessed top managements investing on every field perceived to be lucrative. As top managements had more various investment possibilities and had been unsuccessful in many of their investments, they needed devices to guide their investment decisions. BCG matrix, GE matrix, SWOT analysis and other tools of analysis were developed as devices both to guide the investment decisions and to help to determine the fields where the organization should compete and fight. Again at those times, Penrose (1959) tried to explain the success of the organization by means of the resources owned by the organization.

Then, other approaches such as competitive strategies (Porter 1980; Hall 1980), core skills (Hamel and Pharald 1990), strategic intention (G. Hamel 1991), core competencies and capabilities concepts were developed.

In the literature, an organization's resources have generally been stated to be physical, non-physical (intangible) and monetary resources. The capacities comprising these resources have been variously stated. For example, Zehir, Acar and Tanrıverdi (2006) stated them as global, top management, good/service, marketing, meeting orders, external relations, information systems and technological capacities. In the mentioned study, these capabilities have been considered to be the determinant factors in the success and growth of the organization. Though these capacities can be studied in many different way, in the study by Zehir et., al the consecutive relations and interactions among these capacities were overlooked. So far, we do not encounter any study that deals with the concurrent relations and interactions among the mentioned factors. In this respect, explaining which factors lead to accruing superior technology, how skills of top manager develop, and which abilities are supported by these capabilities can considerably contribute to the literature of management and organization, especially to that of strategic management. Since this study will form a dynamic model explaining the mentioned issues and draw on the gathered data to test it, specific contribution will be made to the literature. Also, because the study will identify the formation process of resources, it will guide the practitioners to develop their capabilities further.

## The Model

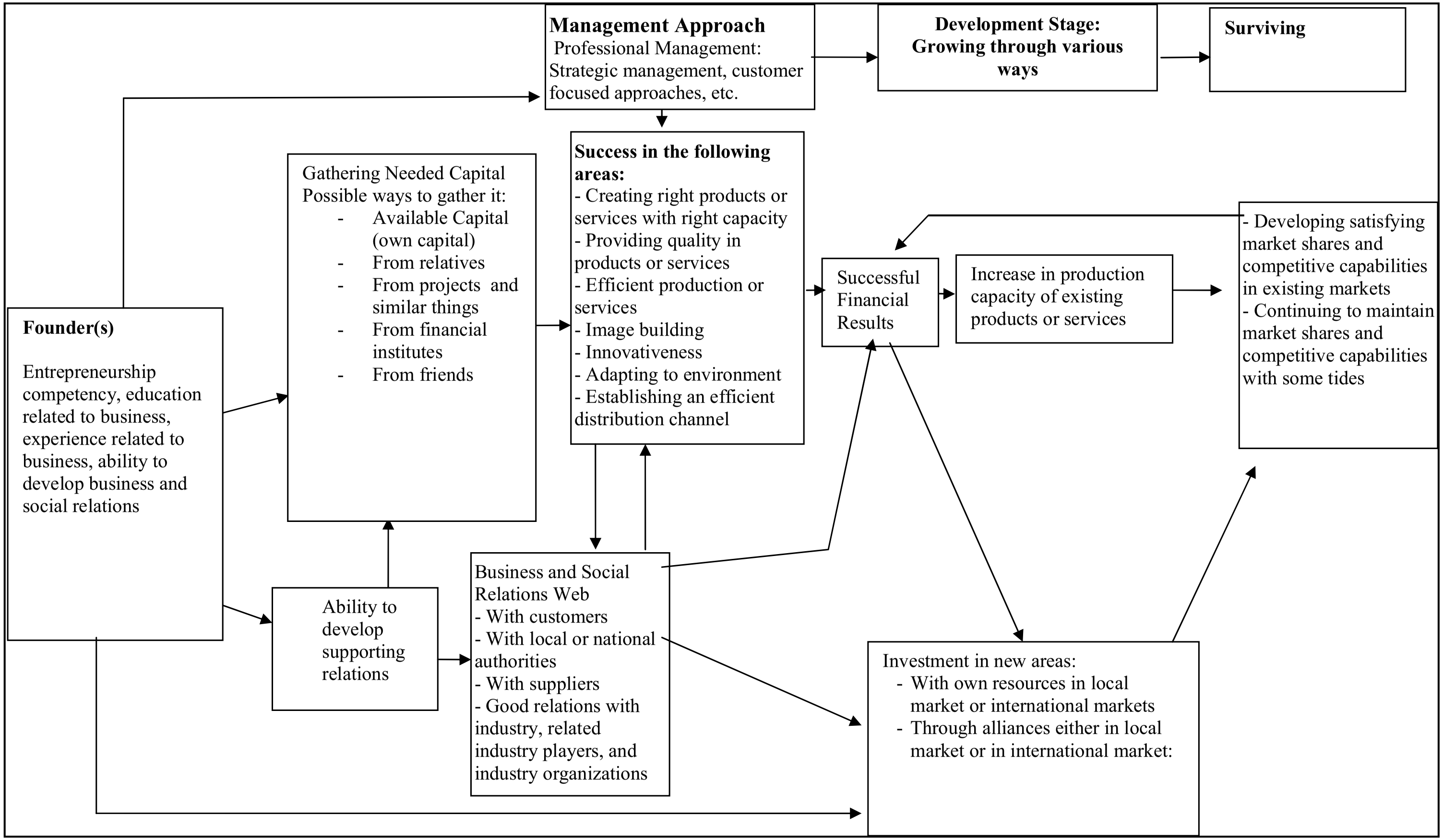
Our model, depicted below, focus on factors that determine the initial success of a business at first. Then, It explains proceedings of growth and, finally, gives conditions of surviving in the long range. Therefore, the study begins to identify determinants of initial success which are stated in the model as having entrepreneurship sense, having education related to business established, experiencing or working in a related business before starting up a business and being able to develop business and social relations. The model suggests that these four factors lead to success in a newly established business or increases the possibility of success for a new comer business man.

If one founder has an entrepreneurship quality, one can sense an opportunity and take actions that might result in a successful business. An ordinary man may realize a business opportunity, but he may not be able to take necessary actions as an entrepreneur can do. An entrepreneur differs from the ordinary in his willingness to take risk and organize a business. He is both able to realize opportunity and get things organize. Our position about entrepreneurship is not as strong as that of Joseph Schumpeter who says that an entrepreneur is a destructive creative and innovative man. An entrepreneur is some one who takes risk and gets things done.

Taking risk is not enough to be successful in a business. Experiencing a business by, for example, working for that business increases the chance of success in establishing a similar business. If some one works for a business, he has opportunity to learn many things such as who are the suppliers and costumers, how production or service process works and what is sought by customers. An experienced man is likely less prone to make mistakes during a business journey compared to inexperienced man. Knowledge and many tools thought at business schools are not understood and learned thoroughly, unless they are applied to real business situation. That is why a real commander or manager is a result of real situations' experiences. Despite advances in information technology and robotics, human factor is the most important one in business, and a successful business man comes out from real business situations, not from classrooms.

Although an entrepreneur may not be made from paper and pencil, new production or service processes might originate to paper and pencil. New management, marketing and organizing approaches have been shaped at schools. Max Weber and Frederick W. Taylor were pioneer of new organizing and production approaches respectively. Juran's and Deming's works leaded to total quality management approach, and, needless to say, there are many and many scholars who have contributed to improvement in doing jobs, business approaches and tools. Education does not only lead to improvement, it may also lead to creativeness and innovativeness, providing that education approach is scientific. Japan did not become Japan because of availability of destructive creative and innovative entrepreneurs, but because of importance given to applied scientific works.

Another important factor that plays vital role in success of a business is the ability to develop useful relations with people with resources, employees, suppliers, customers and local or national authorities. As underlined in the literature review part of this study, a social network enable an entrepreneur to access needed founds to establish a business. From Hawthorn studies today, we know that a business man or a manager’s behaviors are effective on employee behaviors, either through being a role model to them or by convincing them to behave as expected. An entrepreneur, more than a manager, is able to develop relations with people who have a stake within a business. At the start up, good relations with local authorities helps a business to be run smoothly since it may require various permeations from local authorities. Like wise, trustful relations with customers and suppliers are always supportive for a long surviving business. A satisfied customer helps a business image to develop positively through giving references to people around him. Good relations with suppliers might increase quality of products or services and speed of production or services.




**The Model: An Interactive Explanation of Initial Success, Growth and Survival of a Business**

In the model depicted above, it is predicted that a founder's approach opens up the way to a visionary professional management approach. Otherwise, a business stops growing and may survive as a small one. A visionary management approach monitors environment and seeks opportunities to capitalize on so that the business be able to grow within a provided vision framework.

Even though there are many factors effecting an efficient production or service process, choosing a right place and, capacity, and proper layout are among the most important ones since it will be costly to deploy business, reengineer facilities and resize capacity. Professional management is needed here to prevent fatal errors at the start up. Visionary management leads to accumulation of technology which is a fundamental factor for every business in today world. To be in far front in an industry in terms of efficiency, usage of technology fully is a mast. Also, use of technology may help a business to adapt to its environment. Although adapting to environment may seem to contradict innovativeness, it does not. It is impossible to be innovative in all aspects of a business; therefore, a business adapts to its environment in some areas and innovates in others. It is an interactive process; a business adapts to its environment and changes it through innovations.

Both use of technology and innovativeness, besides providing efficiency, might lead to quality products or services which may, in turn, facilitate marketing effort. Technology makes business communications and transactions faster and less costly. Distribution channels are more efficient in terms of delivery and stock costs. Innovativeness, on the other hand, makes a business be able to differentiate itself from its competitors. Costumer focus does in no way diminish importance of quality products or services and production or service processes efficiency. All of them affect each other interactively. A quality product or service with an efficient process does not guaranty successful sells, unless there is effective end efficient marketing effort. Like wise, an effective and efficient marketing does not bring success to a business, unless there are quality or superior products or services throughout a long range.

A long range effective and efficient marketing coupled with efficient production and service process and baked with a business and social relations web result in a successful business, almost for sure. Successful financial results with a visionary management supported by business and social relations web grow business either through increasing investment in the existed industry or open up new avenues through investment in other industries and in international markets. New investments might be stand alone or joint ventures. A business and social relations web increases possibility of joint ventures which allow capitalizing on others' abilities or knowledge such as managerial, marketing, financial, market knowledge, technical knowledge, etc.

Any successful business has its glass seal in its industry. When a business reaches that point, it will sustain its position with some tides, providing that the business is able to protect its competitiveness. The model is its infancy stage and needs to be developed further. However, at this stage, it is able to give an example of a whole picture of a business life stages and relations within it.

## METHOD

The study aims to shed light on the process of survival and growth of the organization; thus, multiple-case study research strategy is adopted. A single case study focuses on a unit which may be an individual, a group, an organization or a country. A case is a typical example that might shed light on some phenomena, or processes of the population from which the case is drown (Yin, 2003). A statistical generalization is not possible, here. Rather, judgmental explanations are developed, and they are tested farther through replication of the research in cases from the same population (Parkhe, 1993). Multiple-case study research includes more than one case to control some variables. For example, a researcher may select one small, middle and big company to see size effect on the phenomenon that is studied. Case study researches, contrary to survey researches, can study historical evolution of firms since they appropriate to longitudinal studies. Through case studies we can understand what events have leaded to what formation or development. Since our study try to explain what factors lead to success, growth, and survival of a firm, and how these factors interact, we decided to use case study research approach. To see whether companies in deferent sectors have different stories or historical development, we adopted multiple case study approach. Also, to identify factors that lead to success, growth and survival, we wanted to include unsuccessful firms in our sample, besides successful firms, so that success factors can be verified. For example, one can claim that firm A is successful because factor X is present. What if factor X is present and firm B is unsuccessful? To verify our explanations we need unsuccessful firms, also.

In this respect, based on the classification of The Istanbul Chamber of Industry (İSO), the mot successful three representatives from each sector are selected from ISO's the most successful 1000 industrial companies list. The 3 most successful companies in each industry of 12 industrial categories were selected according to their assets and equity growth rate, and profits from 1997-2007. We contacted 30 selected companies (2 sectors were vague) and asked them rendezvous for an interview. Companies did not accept to have interview with us, indicating that they have no time for an interview. The questioner (Appendix I) which contains open end questions was sent to the 30 companies. We expected to get unsuccessful business's names from successful ones. However, from 30 companies only 10 joined the study and none of them provided unsuccessful company names in their sectors. We got only one unsuccessful company. Therefore, at the total, 11 companies joined the study. Two of these companies were foreign.

A true research approach, here, would include direct observations of events that have happened to a firm or would be a situation in which a researcher is able to shoot all things that have happened to a firm without interfering with the events. Even today, such a thing is almost impossible. In our research, we wanted to hear founders or senior employees that witnessed the history of their firm. To do that, we prepared open end questions (Appendix I) which aim to get details about important historical events and contemporary information about their companies. That is; we tried to understand who were the founders, what leaded them to invest, what was their background, what were important turning points, what were reasons of their success, what changes happened in their company through out history, etc. To check some information, we also visited the sample company's web sites.

Unfortunately, none of persons that answered questions are the founder of companies. However, they are senior people who can give information about historical evolutions of firms. The questionnaires and archival documents examined and following analyzes developed. The questionnaires are open to persons who are interested in them.

## Findings

Through examination of 11 questionnaires and archival documents following points are identified. They are stated according to the model's stages.

## Founder/s, Gathering Resources, Business and Social relations

First common thing that is seen among 10 sample companies is that founders had experiences either through working in the same area or in some related areas before starting up the business. Another point that can be understood from the questionnaires, the founders are well educated considering conditions of 4-5 decades ago in Turkey. There are signs of local or national authorities support to these businesses. For example, one of founders of a textile firm in the sample got support from the President of the Republic. A founder of an automotive business, whose father was a public prosecutor, got important support and contracts from national authorities. Also, the government's incentives seem to motivate founders to establish businesses. We inferred this point from several cases. Although not very clear, founders are said to be effective in building relations. We have not observed any sign of entrepreneurship quality at founders of these businesses.

.

## Visionary Professional Management Approach, Success and Growth

In 4 of cases, founders are educated people and their family members are also educated. They have had only one or two businesses. There was not any sign of visionary management approach and innovations, except 2 foreign and 2 international joint ventures. In fully local firms, the management approach seems to be adapting to the market through renovation of machines and facilities. That is, they have been market driven firms. Financial resources are mostly equity based with some bank credits. Sticking with one or two businesses and reinvesting earnings to adapt to their environment might be the some of reasons of success in theses businesses.

Successfully answering the market demand leads to growth. Seven firms report their growth as 7 times to 100 times from the start to today. The interviewee of the firm, established in 1953, that produce denim indicates that their firm grow more than 100 times. Investment in IT technology and machinery with education efforts are underlined bye the interviewee. Archival financial reports confirm these seven firms' growth evaluations.

The interviewees indicate that the quality of their productions is very well. The interviewees who state that their firms are the market leader evaluate their management and marketing ability, reputation, human resources and product quality, and financial situation to be better than those of their important rivals. Their financial success reflects the mentioned sayings.

The unsuccessful firm is a special case since it was established by 1000s of agricultural producers or farmers. It has had managerial and marketing problems, and, despite the governments support, it has incurred important losses throughout its history.

## Sustained Growth

Sticking one core business and reinvesting earnings to the business is one of fundamental characteristics of these successful local firms. Foreigner firms are part of international and world wide firms. Their success is based on strong managerial and technological development that their parents have had. Typically, the local firms invested in few new businesses, almost all of which are related businesses or a backward or forward integration to the start up business. It can be said that they have focused on their market and renovate their machinery and facilities to protect their positions.

## Conclusion

Despite the problems that we encountered in research process, we are able to observe some of the model's predictions. The suggestions that education and experiences of founders lead to success in start up business is observed in the most of the cases. Also, it can be said that support or incentives provided bye authorities have role in these businesses. We have not seen any sign of visionary management approach although one firm indicates that it has applied total quality management since 1990. Rather, the local firms tend to adapt to their market or respond to changes in their market. Reinvesting in the core business and not following a multi-businesses strategy seem to be a key for these successful industrial firms. Such a strategy might be said to lead a sustainable growth for the mentioned cases

## Limitations of the Study

First of all, our sample does not include any case from the service sector, and is limited to Turkey' Industrial companies. The sample did not reach to intended sample representation quality, and there is just one unsuccessful case, which is a special one. Also, only two firms accepted having an interview with us. We contacted and sent interview questions to about 30 firms since they did not accept having interview with us, but only 9 returned the forms to us. The results are limited to explained conditions. The model needs to be developed further. A full scale and longitudinal international research might validate the model's predictions.

## APPENDIX I

| Soru Formu | Questionnaire |
|---|---|
| Şu anda kaç işletmeniz var? | Have many businesses do you have? |
| Bu işletmelerin sırasıyla kuruluş tarihlerini ve iş alanlarını (ürettiği mal ve hizmetleri) belirtebilir misiniz? | Could you indicate establishment date of your businesses and their areas (what services and productions are produced)? |
| İlk işletmenin kurucularından birimiydiniz? Bize işletmelerin kuruluş tarihlerini ve kuruluş ekibinin (birden fazla kişi söz konusu ise) kuruluş aşamasındaki eğitim düzeylerini ve deneyimlerinden söz edebilir misiniz (ailede ticari faaliyetler var mıydı, iş kurmadan önce bir yerde çalışmışlar mı, eğitim durumları neydi?). | Are you one of founders of the first business? Could you tell us about founders team's (if there was more than one person) education levels and experiences (were their families business man, did founders worked anywhere before starting up business and what were their education level ?). |
| İşletmenin kuruluşuna yol açan olaylar nelerdi? | What events leaded to the business establishment? |
| Kuruluş için gerekli kaynaklar nasıl sağlandı (fiziksel, insani ve parasal)? | How were needed resources gathered for establishing the business (physical, human and monetary resources)? |
| Ürün veya hizmetlerinizi tüketiciye nasıl ulaştırıyorsunuz (lütfen her bir iş için değerlendiriniz)? Geçmişte farklı uygulamalar var mıydı? Ne zaman değişikliklere gittiniz? | How do consumers access to your products or services (Please, evaluate your every business separately)? Were there any different distribution processes in the past? If there were, when did they begin? |
| Teknoloji edinmek için patent anlaşması yapıldı mı? Kaç kez ve hangi alanlarda, hangi tarihlerde yapıldı? | Did you made any patent agreement? If so, how many times and in what areas did you make patent agreements? |
| Üretim alanında kullanılan makineler veya tezgâhlar ithal mi yoksa yerel pazardan mı edinildi? Bize üretim teçhizatının veya teknolojisinin yenilenme aşamalarını anlatabilir misiniz (olanaklı ise tarihleri ile birlikte)? | Were machines and devices used in production imported or bought in local market? Could you tell us renovation stages in production facilities and technologies (please, provide dates if possible)? |
| Başlangıç yatırımınızı 100 kabul etsek, şu anki varlıklarınızın değeri nedir? Lütfen bu rakama diğer yatırımlara veya satın almalara aktarılan kaynakları da ekleyiniz. | If we assume that your initial investment was 100, what is value of your net assets, now? Please, add to that value resources transferred to other investments and acquisitions. |
| En önemli rakiplerinizle kıyasladığınızda, kendinizi aşağıdaki alanlarda nasıl değerlendirir siniz? Eğer rakiplerinizden daha iyi iseniz bunu neye bağlıyorsunuz (lütfen her bir faktörü ayrı ayrı değerlendiriniz)?<br><br>- Ürün kalitesi<br>- Teknoloji düzeyi<br>- Üretim sürecinde ve üründe yenileme yapabilme düzeyi<br>- Yönetim kabiliyeti<br>- İşletme yönetici ve çalışanlarının kalitesi<br>- Pazarlama kabiliyeti<br>- Birim maliyetler<br>- Firma imajı<br>- Tanınmışlık düzeyi<br>- Mali durum<br>- Karlılık<br>- Özsermaye ve aktiflerde büyüme başarısı<br>- Diğer (lütfen karşılaştırma yapmak istediğiniz diğer alanları ekleyiniz)…………………… | How would you evaluate yourself in the following areas compared to important rivals? If you are better than your rivals, why do you think it is so (please evaluate each factor separately)?<br>- Quality of your product<br>- Level of technology<br>- Ability of innovation level in productions and production process<br>- Management capability<br>- Quality of managers and employees<br>- Marketing capability<br>- Unit cost<br>- Image of the company<br>- The level of reputation<br>- Financial situation<br>- Profitability<br>- Growth success in equity and assets<br>- Others (please other areas that you would like to evaluate) |
| Yukarıda belirtilen alanlarda, süreç içinde meydana gelen değişikleri anlatabilir misiniz? | Could you tell us about changes that happened in areas stated above through time? |
| İşletmenizin bilgi teknolojilerini kullanma yeteneğini değerlendiriniz. Entegre bir sistem mevcut mu? Bu sistemin işletmenize sağladığı faydalar nelerdir? | Please evaluate your company's ability to use information technology. Is there integrated information technology system? What kind of benefits does this system provide to your company? |

| | |
|---|---|
| İşletmenizin başarısını veya kendi alanında Türkiye pazarında ilkler arasında olmasını hangi faktörlere bağlıyorsunuz? Lütfen önemli dönüm noktalarını ve bütün tarihsel olayları ve gelişmeleri göz önünde bulundurunuz. | What reason/s could you give us for your success or for being among first business in your industry in Turkey? Please, consider all turning points, events and developments throughout past. |
| İhracat yapıyor musunuz? Lütfen grubun bütün işletmelerini ayrı ayrı değerlendiriniz ve tarihsel süreçte ihracat payının satışlar içindeki payını yaklaşık olarak belirtiniz. | Do you export? Please, evaluate each business separately and indicate approximately export share in total sells in during the past. |
| Yabancı işletmelerle ortaklığınız var mı? Varsa, hangi yılda ve hangi alanda kurulmuştu? | Do you have international joint ventures? If so, in what year and areas were they established? |
| Başka bir ülkede ihracat dışında bir faaliyetiniz var mı? Varsa ne tür faaliyetler var bunların oluşum ve tarihsel sürecini belirtebilir misiniz? | Besides export, do you have any other activity in foreign countries? If so, what kind of actives are they, and could you indicate establishment process of them? |
| Kurucu kişilerin veya yönetimin hammadde ve malzeme sağlayan insanlarla ilişkilerini değerlendirebilir misiniz? Tedarik ilişkisi dışında karşılıklı müşteri bulmada veya üretim konusunda yardımlaşma olmuş mudur veya oluyor mu? | Could you evaluate founders or management relations to suppliers? Was there or is there any assertiveness beyond supplier-buyer relationship such as cooperation in finding costumer or help in production process? |
| Müşteri tabanınızı nasıl oluşturdunuz? Bunda etkili olan faktörleri değerlendirir misiniz? Örneğin kurucu kişilerin kişisel ilişkilerinin veya arkadaşlıklarının rolü nedir? Ürünlerin fiyat ve kalitelerinin rolü nedir? Pazarlama faaliyetlerinin rolü nedir? vb. | How did you form your costumer base? Could you evaluate effective factors at building costumer base? For example, what is the role of founders' personnel relations or friendship with other people? What is the role of price and quality of products? What is the role of marketing efforts? Etc. |
| İşletmenizin veya grubunuzun devrettiği veya çekildiği işler oldu mu? Olduysa bu işlerden çekilme nedenleriniz nelerdi? Lütfen detaylandırınız. | Was there any business that your group withdrew or sold? If so, what are reasons for these actions? Please, provide details. |
| Varsa yönetici ve çalışanlarınızın katıldığı eğitim programlarını ve sürelerini belirtiniz. | Please, indicate education programs and their durations that your employees joined if there is any. |
| Yöneticilerinizde ve çalışanlarınızda diğer işletmelerin yönetici ve çalışanlarında olmayan kabiliyetler ve özellikler olduğunu düşünüyor musunuz? Olduğunu düşünüyorsanız, bunların varlığını neye bağlıyorsunuz? | Do you think that there are capacities and characteristics your managers and employees posses, but others do not? If so, do you refer those to what reasons? |
| Yönetim yaklaşımında değişiklikler yaşandı mı? Ne zaman? Nasıl değişikliklerdi? Çalışanların anlayışları nasıl değişti? | Did any change happen in management approach? When? What were these changes? How did understandings of employees changed? |
| İşletmenize 1997-2008 arasında yeni sermaye koydunuz mu? | Did you add new capital to your business between 1997-2008? |
| 1997'den bu yana işletme karlarınızdan başka iş alanlarına kaynak oluşturdunuz mu? Şuana kadar karlarınızın yüzde kaçını başka işlere ayırdınız? | Have you created resources for other areas from your profits since 1997? So far, how much percent of your profits have you transferred to other business or activities? |
| Faaliyet gösterdiğiniz sektörde varsa başarısız olan işletmenin/işletmelerin ismini/isimlerini belirtiniz. | Please, indicate name/s of unsuccessful business/es in your industry if there is any. |

İşletmedeki çalışma süreniz?
Çalışma yaşamınızın süresi?
İşletmede bulunduğunuz pozisyon?
Lütfen şu anki pozisyon dışında daha önce bulunduğunuz pozisyonu veya pozisyonları süreleri ile birlikte belirtiniz

How long have you been working for your company?
What is duration of your working life?
What is your position in your company?
Please indicate your position or positions with their durations before existing position

## REFERENCES


1. Aldrich, H., and Auster, E. (1986) 'Even Dwarfs Started Small: Liabilities of Age and Size and Their Strategic Implications', In L. Cummings & B. Staw (Eds.), Research in Organizational Behavior, vol. 8, pp. 165-198. San Francisco: JAI Press.
2. Amit, R. and Schoemaker, P.J.H. (1993) 'Strategic Assets and Organizational Rent', Strategic Management Journal, 14, pg. 33-46.
3. Barney, J. (1986) 'Strategic Factor Markets: Expectations, Luck, and Business Strategy', Management Science, October, pp. 1231–1241.
4. Bourdieu, P. (1983) 'Forms of Capital', In: Richardson, J., Editor, , 1983. Handbook of Theory and Research for the Sociology of Education, Greenwood Press, New York.
5. Bruno, A.V. and Tyebjee, T.T. (1982) 'The Environment for Entrepreneurship', In: Kent, C.A., Sexton, D.L. and Vesper, K.H., Editors, 1982. Encyclopedia of Entrepreneurship, Prentice-Hall, Inc., Englewood Cliffs, NJ, pp. 288–315.
6. ***Brush***, C. G., & Greene, P. G. (1996) 'Resources in the New Venture Creation Process: Strategies for Acquisition', Paper presented at the Annual Meetings of the Academy of Management, Cincinnati, OH.
7. Coleman, J.S. (1988) 'Social Capital in the Creation of Human Capital', American Journal of Society, v.94, pp. 95-120
8. Dollinger, M.J. (1995) 'Entrepreneurship: Strategies and Resources' , Richard D. Irwin, Homewood, IL.
9. Fukuyama, F. (1996) 'Trust', New York: Free Press.
10. Grant, R.M. (1991) 'The Resource-Based Theory of Competitive Advantage: Implications for Strategy Formulation', California Management Review, Vol.33, pp.114-135.
11. Greene, P. G., ***Brush***, C. G., & Brown, T. E. (1997) 'Resource Configurations in New Ventures: Relationships to Owner and Company Characteristics', Journal of Small Business Strategy, 8(2), 25-40.
12. Greene, Patricia Gene and Brown, Terrence Edison (1997) 'Resource Needs and the Dynamic Capitalism Typology', Journal of Business Venturing, Vol. 12 Issue 3, p161, 13p
13. Hamel, G. (1991) 'Competition For Competence And Inter Partner Learning Within International', Strategic Management Journal, Vol. 12, pp. 83-103.
14. ***Hart***, M. M., Greene, P. G., & ***Brush***, C. G. (1997) 'Leveraging Resources: Building an Organization on an Entrepreneurial Resource Base', Paper presented at the 17th Annual Babson Conference on Entrepreneurship Research, Wellesley, MA.
15. Hart, S.L. (1995) 'A Natural-Resource-Based View of the Firm', The Academy of Management Review, Vol. 20 No. 4, pp. 986-1004.
16. Higgins, J. M. (1994) 'The Management Challenge', Macmillian Publishing Company, New York, USA.
17. Parkhe, A. (1993) ' 'Messy' Research, Methodoligical Predispositions, and Theory Development in International Joint Ventures', Academy of Management Review, Vol 18 Issue 2, p227-42p.
18. Penrose, E. T. (1995) 'The Theory of the Growth of the Firm', New York: Oxford University Press.
19. Peteraf, M.A. (1993) 'The Cornerstone of the Competitive Advantage: A Resource-based View', Strategic Management Journal, Vol.14, pp.179-191.
20. Porter, M. E. (1998) 'Competitive Strategy: Techniques for Analyzing Industries and Competitors', Free Press, New York, USA.
21. Prahalad. C.K. and Hamel, G. (1990) 'The Core Competence of the Corporation', Harvard Business Review, USA.
22. Rumelt, R. P. (1984) 'Towards a Strategic Theory of the Firm', In R. B. Lamp (Ed.), Competitive Strategic Management. Englewood Cliffs, NJ: Prentice Hall.
23. Shulman, J. M. (1997) 'Debt and Other Forms of Financing', In W. D. Bygrave (Ed.), The Portable MBA of Entrepreneurship, pp. 195-235. New York: John Wiley & Sons.
24. Stevenson, H.H. and Gumpert, D.E. (1985) 'The Heart of Entrepreneurship', Harvard Business Review, pp. 85–94 March–April.
25. Stinchcombe, A. L. (1965) 'Social Structure and Organizations', In J. G. March (Ed.), Handbook of Organizations, pp. 142-194. Chicago: Rand McNally.
26. Wernerfelt, B. (1984) 'A Resource-Based View of The Firm', Strategic Management Journal, 5, pg. 171-180.
27. Yin, R.K. (2003) 'Application of Case Study Research', Sage Publications, 2. Edition.
28. Zehir, C., Acar, A. Z. and Tanrıverdi, H. (2006) 'Identifying Organizational Capabilities As Predictors of Growth and Business Performance', The Business Review, Vol. 5, Iss. 2; pg. 109.

# IS INTELECTUAL CAPITAL ANTECEDENT OF ENTERPRENEURSHIP ORENTATION?

**Erol Eren**
**Beykent University, Turkey**

**Ebru Beyza Kocapınar**
**Yeditepe University,Turkey**

## ABSTRACT

*Knowledge economy, which is characterized by the complex and dynamic competitive environments, knowledge-based resources (human capital, structural capital and market capital) represent the source of competitive advantage for the firms. In order to be able to seize the opportunities, make product and process innovations, be proactive in the market place, entrepreneurial firms have to reconfigure their intangible assets (Jantunen et al., 2005). The objective of this research is to empirically examine intellectual capital as a competitive knowledge resource of firms, initiate entrepreneurial climate that affect the organizational performance as financial and innovative outcomes. Recent conceptual models suggest that entrepreneurial orientation depends on the acquisition, the integration and the exploitation of knowledge (Hayton, 2002). According to this conceptual framework a model is developed to examine the direct and the mediator relation between intellectual capital and entrepreneurial orientation. To investigate the stated relationships data will be collected from Turkey's Top 500 Industrial Enterprises. Questionnaires are prepared by the researchers based on the measurement instrument used by Subramaniam &Youndt (2005), Bontis (1998) and Dess & Lumpkin (1996) after the preliminary survey that is done for the reliability and validity analysis of the measurement instrument which is modified for cultural differences and for the purposes of this study, will be distributed via mail and the internet site. Data will then be analyzed by the SPSS statistical program.*

## INTRODUCTION

Fundamental changes have been wrought in the global economy which are changing the basis of firm level competitive advantage, and with it the functions of management. The decreased cost of information flow increases in the number of markets, the liberalization of product and labor markets in many parts of the world, and the deregulation of international financial flows is stripping away many traditional source of competitive differentiation and exposing a new fundamental core as the basis for wealth creation (Teece, 2000, p.3).

With the shift from seller's markets to a buyer's markets and the development of the resource- and knowledge-based view of firms, intellectual capital has been identified as a key resource and driver of organizational performance and value creation (Itami, 1987; Teece 200; Nahapiet and Ghoshal 1998). According to the resourced-based view of the firm, sustainable competitive advantage is derived from control of unique and inimitable knowledge-based resources (Barney, 1991). Teece (1998) claimed that a competitive advantage of firms in today's economy does not result from its market position but difficult-to-replicate the knowledge-based assets and the manner they are developed (Marr and Ross, 2005). Organizational and technological capabilities offer sustainable competitive advantages to a firm in rapidly changing markets by recognizing changes and understanding their consequences and reconfiguring its firm-specific assets base. In order to be able to seize the opportunities, make product and process innovations, and be proactive in the market place, entrepreneurial firms have to understand and reconfigure their intangible assets (Jantunen et al., 2005).

## Intellectual Capital

Organizational knowledge is an important bundle of intangible resources that can be the source of a sustainable competitive advantage (Wiklund and Shepherd, 2003). Prior research conceptualizes intellectual capital as the sum of all knowledge and knowing capabilities that can be utilized to give a company competitive advantage (Nahapiet and Ghoshal, 1998; Stewart,1991). In 1991 Tom Stewart was the first researcher who defined intellectual capital as "the sum of everything everybody in your company knows that gives you a competitive edge in your marketplace" (Stewart, 1991). After Stewart, other researchers and practitioners try to explain the terms in different ways. Hudson (1993) defined the IC as a personal asset of individuals, a combination of genetic inheritance, education, experience and attitude about life and business (Bontis, 1998). Nahapiet and Ghoshal (1998) use the term intellectual capital to refer to the knowledge and knowing capability of a social collective, such as an organization. On the other hand, Brooking (1997) used the intellectual capital term in explaining the combined intangible assets which enable the company to functions and broaden definition of the IC market assets, the human centered assets, the intellectual property assets and the infrastructure assets. Marr and Schimuma (2001) pointed out that 'IC is the group of knowledge assets that are attributed to an organization and most significantly contribute to an improved competitive position of this organization by adding value to defined key stakeholders'.

All intellectual capital researchers agree that it is not a unidimensional construct; rather it resides at various levels like individual, network and organizational one. So, intellectual capital is not constrained to the knowledge held by individuals, but also includes knowledge stored within organizational database, business processes, systems and relationships (Youndt & Subramaniam, 2004:335). Generally the literature has identified three sub-dimensions that constitute the concept of intellectual capital: human capital, structural capital and customer capital.

***Human Capital+ Structural Capital + Customer Capital = Intellectual Capital***

Human capital represents the individual knowledge stock of an organization by its employees (Bontis ,2001; Youndt et al, 2004) This knowledge resources can be skills, experience, expertise, ideas, knowledge, competencies, abilities and values of employees. According to Skandia (1996), human capital is accumulated value of investments. However, Hudson (1993) claimed that combination of genetic heritance, education, experience, attitude about life and business can be defined as human capital on individual level. Human capital is important for entrepreneurial organizations because it is a source of innovation and strategic renewal, whether it is from brainstorming in a research lab, daydreaming at the office, throwing out old files, re-engineering new processes, improving personal skills or developing new leads in a sales little black book (Bontis, 1998:65).

Structural capital is defined as the knowledge that stays within the company at the end of working day. It represents institutionalized knowledge and codified experience stored in structure, systems, applications, procedures, databases, patents, trademarks, manuals, policies, vision and values (Hall, 1992; Itami, 1987; Bontis, 1996; Stewart, 1997). Bontis (1998) argued that an individual can have a high level of intellect, but if the organization has poor systems and procedures by which to track his or her actions, the overall intellectual capital will not reach its fullest potential.

Last dimension of the IC is customer capital, the value that results from an organization's relationship with customers (Chang & Tseng, 2005). The main idea of customer capital is the knowledge embedded in the marketing channels and customer relationships that an organization develops through the course of conducting business which will enhance its competitive advantage (Bontis, 1998; Bontis et al.,2000; Bontis and Fritz-enz, 2002). Reichhed (1993) found that a 5 percent increase in customer retention resulted in an increase in average customer lifetime value of between 35 and 95 percent, leading to significant improvements in company profitability. Additionally, Holmlund and Kock (1996) pointed out that long term relationships with customer allow access to detailed and useful knowledge about the customers. Thus, new knowledge and new ideas can be turned into to new products and services which are the source of innovation (Tsan & Chang, 2005:290).

Many resource-based view scholars like Prahalad (1996), Grant (1996), Barney (1991) have argued that the intangible assets are the pre-eminent drivers of competitive advantage. The main reason under this assumption is difficult to replicate intangible assets as opposed to physical or tangible assets (Barney, 1991; Dierickx and Cool, 1989; Zander and Kogut, 1995). Especially, the knowledge-based view of the firm posits that tacit and contextualized knowledge bases due to their inimitability, help facilitate superior performance (Youndt et al. 2004).

Over the past decade researchers have started to emphasize the importance of intellectual capital. Academics have traditionally been very interested in how intangible assets reflect on the performance of firms. Accordingly, a recent surge of writings and empirical studies examined the development, usage, and performance effects of intellectual capital (Edvinsson and Malone, 1997; Gupta and Govindarajan, 2000; Stewart, 1997; Tsai and Ghoshal, 1998). Edvinsson and Malone (1997), Bontis and his friends' (1998), Youndt et al. (2004), all researches found that human, structural and customer capital have a significant effect on organization performance. However Bontis and friends (2000) studies in Malaysians' companies have shown that intellectual capital has a significant and substantive relationship with business performance regardless of industry sector. On the other hand, Subramaniam and Venkatraman (2001), empirically demonstrated how the tacit knowledge contributes to the development of superior organizational capabilities, which, in turn, increase performance. Hence, the knowledge-based view of the firm provides strong rationale as to intellectual capital's role in enhancing organizational performance (Youndt et al., 2004:344).

## Entrepreneurial Orientation

Entrepreneurship has been an interest to academics and practitioners for the past three decades. The term 'entrepreneur' has been used by Cantillon in 1755, to describe an individual with foresight and ingenuity who, within the parameters of economic markets, are willing to embrace uncertainty and engage proactively in pursuits of profit (Küçük,2005). The modern concept of entrepreneurship in which much of the academic research is grounded was articulated by Schumpeter (1934), who saw an entrepreneur as visionary and innovator, making new combination of resources in an effort that could lead to "creative destruction " of existing combinations as a new product, process or market that replaces the old (Küçük,2005).

The concept of entrepreneurship has been studied from both individual and corporate perspectives (Covin and Slevin, 1991, Naman Slevin, 1993, Dess et al., 2003). In 1980s, most of the entrepreneurship researches focused on individual as an entrepreneur. However, researchers pointed out that individual trait approach did not lend itself to measurability, replication and generalizability (Covin & Slevin, 1994). Academics started to investigate firm behavior instead of individual characteristics which can understandable, measurable and transferable to organization strategies. Firm level entrepreneurial behavior can be managed through the creation of particular organizational strategies, structures, systems and cultures (Covin and Slevin ,1991).

Entrepreneurial orientation first defined by Miller. According to Miller (1983) entrepreneurial firm is one that 'engages in product market innovation, undertakes somewhat risky ventures, and is first to come up with proactive innovations, beating competitor to the punch" (1983:771).On the other hand Lumpkin and Dess (1996), used "entrepreneurial orientation" to refer to the strategy making processes, methods and styles of firms that engage in entrepreneurial activities. As such, it reflects how a firm operates rather than what it does (Lumpkin and Dess, 1996). Underlying an entrepreneurial orientation is a tendency to pursue the creation and acquisition of new knowledge and the integration of new knowledge and capabilities with existing resources in the form of new combinations (Hayton, 2005).

Miller (1983) conceptualizes entrepreneurial orientation in three dimensions: proactiveness, innovation and risk taking. Additionally Lumpkin and Dess (1996) added two more dimensions that include a propensity to act autonomously and aggressively toward competition.

Organizational innovation represents a significant change in the organization, whether a response to changes in its internal or external environment or as preemptive action to influence an environment (Damanpour, 1991). Innovation concept is the most researched term in both individual and organizational entrepreneurship studies. Schumpeter (1934) was the first writer who used innovation in explaining entrepreneurship. Lumpkin and Dess (1996, p. 142) defined innovation dimension as "the tendency of a firm to engage in and support new ideas, novelty, experimentation and creative processes that may result in new products, services or technological processes. Beside Covin and Slevin proposed innovation as "the extensiveness and frequency of product innovation and the related tendency toward technological leadership (1991,p.10).

Risk, as the possibility of loss, may be viewed as an inherent characteristic of innovativeness, new business formation and aggressive or proactive actions of existing firms (Antoncic & Hisrich, 2003, p.17). Risk taking dimension is the earliest characteristic of entrepreneur. Miller and Friesen (1978) used risk taking as "the degree to which managers are willing to make large and risky resource commitments–i.e., those which have a reasonable chance of costly failures (Dess & Lumpkin, 1996). It largely reflects the organization's willingness to break away from the tried-and true and venture into unknown (Wiklund, 2003). Thus in organizational risk taking behavior, the management will take risk with regard to investment decisions and strategic actions in uncertainty conditions (Covin and Slevin, 1991).

Most academicians used proactiveness dimension in explaining organizational posture of anticipating and acting on future wants and needs in the marketplace, that create a first mover advantage, to rivals (Wiklund, 2003). So then proactiveness is critical for entrepreneurial firms because it suggest a forward looking perspective that is along with innovative or new venturing. Additionally Miller and Friesen (1978) claimed that proactive firms are the one that is quickest to innovate and the first to introduce new products or services.

Competitive aggressiveness is the last dimension of entrepreneurial orientation which refers to a firm's rivals propensity to directly and challenge its competitors to achieve entry or improve position, that is, to outperform industry rivals in the marketplace (Lumpkin &Dess, 1996:148). According to Covin and Covin (1990) competitive aggressiveness is managerial disposition in explaining organizational willingness and the desire to take on and dominate the competitors. Although same researcher thought there is no need to separate proactiveness and competitive aggressiveness. (Guth and Ginsberg, 1990; Zahra,1991), Lumpkin (1998) and his colleagues (1997), empirically explained that the two dimension can be distinct, they tend to vary independent. They stated that proactiveness relates to pioneering in seizing market opportunities, while competitive aggressiveness is deal with an aggressive organizational relationship to its competitors (Antoncic & Hisrich, 2003).

In strategy literature, organizations that have an entrepreneurial orientation have been found to have significant, positive performance differentials over other firms (Lumpkin & Dess, 1996; Covin & Slevin, 1996; Ireland & Hitt, 2000; Zahra and Covin, 1995; Zahra et. al. 1999; Wiklund and Shepherd, 2005). But on the other side the empirical results are mixed. Lee and his friends study's (2001) showed that only weak evidence of a positive relationship between entrepreneurial orientation and the start-up's performance, whereas Slater and Narver (2000) found no relationship at all, with business profitability. Additionally Zahra and Garvis (2000) suggest that entrepreneurial activities enhance overall and foreign profitability and revenue growth, and that entrepreneurship moderates the relationship between environmental hostility and performance, to the advantage of the latter (Jauntan, 2007:226).

Lumpkin and Dess (1996) in their conceptual model proposed that factors internal and external to the firm may moderate the relationship between EO and performance. Empirically, research has found that the effect of EO on performance may be diverse in different types of environments. Besides Wiklund and Shepherd (2003) suggest that an entrepreneurial orientation enhances the relationship between a firm's knowledge-based resources and its performance. Entrepreneurial orientation supports sustained competitive advantage through the continuous generation and exploitation of new sources of knowledge. Therefore, OE can have significant impact upon organizational financial and market performance (Hayton 2005).

According to entrepreneurship academics EO refers to a firm's strategic orientation, capturing specific entrepreneurial aspects of decision-making styles, methods and practices so it reflects how firm operates rather than what it does (Lumpkin and Dess, 1996). Wiklund and Shepherd (2003) pointed out that EO clarifies how a firm is organized knowledge resources in order to discover and exploit market opportunities and product innovations. Moreover, they argued that EO captures a firm's organization toward entrepreneurship and enhance other firm resources. On the other hand Zahra, Nielsen and Bogner (1999), suggested that knowledge integration and learning may be a central element in theoretical explanation of why EO is positively associated with firm performance. If this is the case, then an important set of resources that are expected to be associated with entrepreneurial orientation are the intellectual capital assets that a firm controls (Hayton, 2002).

Based on the literature review, the research model in, Figure 1 is developed to measure extended organizational resource as intellectual capital which is antecedent to a firm's ability behaves entrepreneurially.

***$H_1$: Intellectual Capital has a positively related to firm performance.***

***$H_2$: EO mediates the relation between intellectual capital and firm performance***

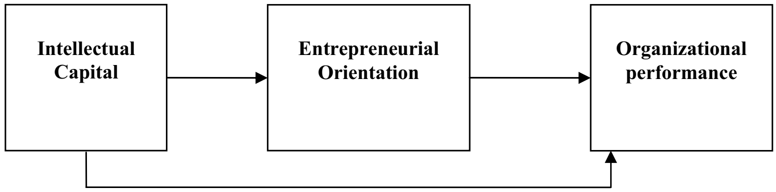



**Figure 1: The Proposed Research Model**

# METHODOLOGY

## Sample

The goal of this study is to empirically explore the association between intellectual capital and entrepreneurial orientation among Turkish companies. The common point of the international studies in both intellectual capital and entrepreneurial orientation is large firms with large sample sizes (Bontis, 2002). Because of not having enough resources, small and middle size enterprises could not start entrepreneurial applications. Thus the participants of the study will be chosen from the list of Turkey's Top 500 Industrial Enterprise obtained from The Istanbul Chamber of Industry.

The focus on middle managers is consistent with the growing recognition of the key role these managers play in promoting or stifling corporate entrepreneurship efforts (Burgelman, 1983b; Floyd and Woolridge 1992, 1994; Pinchott 1985; Nonaka and Takeuchi, 1995). On the other hand information asked in both intellectual capital and entrepreneurial orientation questions are very specific that only middle managers can answer, so respondents are chosen from middle managers.

## Instruments

A measurement scale is adopted from prior studies. All instruments were first translated into Turkish, and then these Turkish versions were again translated into English by researchers, and necessary modifications were made accordingly. All scales used a five-point Likert-type scale, ranged from 5 “totally agree” to 1 “totally disagree”

***Intellectual Capital Scale*** After examining previous studies, according to the framework, new measurement scale was developed by researches. Intellectual capital was measured with three dimension human capital, structural capital and customer capital. These 17 questions were taken from by Subramaniam & Youndt (2005), Bontis (1998), Chen, Zhu Xie (2004), Hayton (2005), Pablo’s (2003) and Hall (1993). Intellectual Capital Questionnaire, a five-point Likert-type scale, with anchors of “totally agree” to “totally disagree” is used to collect responses.

***Entrepreneurial Orientation Scale:***

According to Dess and Lumpkin, (1996) the five dimension which are autonomy, innovativeness, risk taking, proactiveness and competitive aggressiveness, is useful for characterizing and distinguishing the key entrepreneurial processes in firm’s entrepreneurial orientation. Miller was the first academician who developed the scale but Dess and Lumpkin (1996,1998) improved the scale. In this study Entrepreneurial orientation divided four sub-dimensions and was measured by Dess and Lumpkin’s (1996) seventeen –item scale.

***Performance Scale***

In this study, two performance criteria are used to measure the organizational performance which is financial performance and market performance. Organization financial performance scale is integrated from Lumpkin & Dess (1996) ;Wiklund & Shephard (2003);and market performance scale is adapted from Antoncic (2000); Zahra (1993); Hagedoorn & Cloodt (2003) performance criteria’s. According to Wiklund and Shepherd (2003) performance is multidimensional and performance comparisons with competitors reveal important information. As a result middle managers were asked to compare the development of their own firms over 3 years relative to their industry competitor for 16 different dimension of performance; like return on sales, profitability per customer, revenue growth, return on investment, profit growth, return on assets, market new products before competitors, rate of new product introduction into market, number of new product /process add by company, your company spending on new product development, number of patent and patent citations. Organizational performance questionnaire, a five-point Likert-type scale, with anchors of “totally high over the industry average” to “totally low from the industry average” was used to collect responses.

## Data Collection and Procedure

First, pilot study was conducted to 120 employees from 20 companies to analyze the reliability of the instruments. After the pilot study a cover letter and questionnaires were mailed directly to the middle and top managers in each of the 500 organizations’ factories and headquarters. After five weeks because of the low return responses, a new cover letter and same questionnaires were sent to non-respondents. However out of 1000 questionnaires distributed in Turkey's Top 500 Industrial Enterprise 376 were returned which yielded a return rate of 37 %.

# RESULTS

## Factor Analyses

The factor structure of the data gathered by Intellectual Capital scale was analyzed using principal components analysis with varimax rotation. This analysis yielded three factors with Eigen value over 1.00 that explained 65, 88 %of the total variance. The IC subscale has 17 items. After the first factor analysis, three factors emerged and three item was eliminated. When the factor analysis was run again three factors emerged , labeled as “structural capital,” “human capital” and “customer capital ” (Table 1).

The same procedure was repeated for the data collected by EO instrument and this analysis also yielded four factors explaining the 72,4% of total variance. The seventeen items measuring structure were loaded on four factors after the first factor analysis. No item was eliminated. The factors were labeled as “Proactiveness”, “Risk taking”, “innovativeness” and “competitive aggressiveness” (Table 2).

The sixteen items measuring performance were loaded on two factors after the first factor analysis. Four item had to be eliminated because of low levels of reliability. When the factor analysis was run again, two factors that emerged labeled as “financial performance” and “innovation performance” (Table 3)

**Table 1. Reliability and Factor Analysis of Intellectual Capital**

| Intellectual Capital | Variance | Loading | Cronbach Alpha |
|---|---|---|---|
| **1.Structural Capital** | **28,18** | | **,90** |
| Q15 | | ,804 | |
| Q12 | | ,788 | |
| Q16 | | ,770 | |
| Q17 | | ,753 | |
| Q13 | | ,739 | |
| Q14 | | ,709 | |
| **2. Human Capital** | **20,05** | | **0,83** |
| Q3 | | ,835 | |
| Q1 | | ,803 | |
| Q2 | | ,733 | |
| Q4 | | ,699 | |
| **3. Customer Capital** | **17,65** | | **0,77** |
| Q9 | | ,769 | |
| Q11 | | ,714 | |
| Q10 | | ,713 | |
| Q8 | | ,671 | |
| **Total Variance explained %65,88**<br>**KMO: 0,904**<br>**p: ,000 (Bartlett's Test)** | | | |

Table 2. Reliability and Factor Analysis of Entrepreneurial Orientation

| Entrepreneurial Orientation | Variance | Loading | Cronbach Alpha |
|---|---|---|---|
| **1.Proactiveness** | **21,66** | | **,90** |
| Q7 | | ,869 | |
| Q8 | | ,815 | |
| Q9 | | ,762 | |
| Q6 | | ,754 | |
| Q10 | | ,603 | |
| **2. Risk Taking** | **20,01** | | **,86** |
| Q3 | | ,828 | |
| Q2 | | ,798 | |
| Q5 | | ,767 | |
| Q4 | | ,757 | |
| Q1 | | ,717 | |
| **3. Innovativeness** | **17,51** | | **,89** |
| Q16 | | ,884 | |
| Q15 | | ,845 | |
| Q14 | | ,709 | |
| Q17 | | ,679 | |
| **4. Competitive Aggressiveness** | **17,86** | | **,76** |
| Q12 | | ,831 | |
| Q11 | | ,780 | |
| Q13 | | ,723 | |

**Total Variance explained %%72,04**
**KMO: 0,902**
**p: ,000 (Bartlett's Test)**

Table 3. Reliability and Factor Analysis of Performance

| Organizational performance | Variance | Loading | Cronbach Alpha |
|---|---|---|---|
| **1. Financial Performance** | **38,33** | | **,94** |
| Q7 | | ,867 | |
| Q2 | | ,845 | |
| Q9 | | ,822 | |
| Q10 | | ,820 | |
| Q8 | | ,815 | |
| Q4 | | ,790 | |
| **2. Innovation Performance** | **37,44** | | **,92** |
| Q12 | | ,875 | |
| Q13 | | ,852 | |
| Q11 | | ,812 | |
| Q15 | | ,793 | |
| Q14 | | ,773 | |
| Q16 | | ,768 | |

**Total Variance explained %75,79**
**KMO: 0,925**
**p: ,000 (Bartlett's Test)**

The relationships between dependent and independent variables were tested by hierarchical regression analyses. As can be seen on Table 4, a positive relationship between intellectual capital and both innovation and financial performance was observed and $H_1$ was accepted.

As can be seen in the research model, EO was assumed to mediate the relationship between intellectual capital and organizational performance. To test mediating effect of EO, three stages multiple regression method was used (Baron and Kenny, 1986). In this method, first the effect of IC (independent variable) on EO (intervening variable) was analyzed. Second, the relationship between independent and dependent variables was tested. If the results in both levels were significant, in the third level independent and intervening variables were tested together to understand their effects on dependent variables. If the effect of independent variable on dependent variable was insignificant or has lower coefficient (beta), this variable can be discussed as an intervening variable. The result of the regression analysis of intervening variable was presented in Table 4 and also $H_2$ was accepted.

**TABLE 4 The Three Stages Multiple Regression Analysis of Entrepreneurial Orientation**

| **First Stage Variables** | **Entrepreneurial Orientation** | |
|---|---|---|
| Intellectual Capital | .602*** | |
| $R^2$ | .362 | |
| **Adjusted $R^2$** | .359*** | |
| F Value of Model | 105.544*** | |
| **Second Stage Variables** | **Innovation Performance** | **Financial Performance** |
| Intellectual Capital | .299*** | .26** |
| $R^2$ | .089 | .068 |
| **Adjusted $R^2$** | .084*** | .063*** |
| F Value of Model | 18.244*** | 13.535** |
| **Third Stage Variables** | **Yenilik Performansı** | **Finansal Performansı** |
| Intellectual Capital | .134 | .089 |
| Entrepreneurial Orientation | .275** | .285*** |
| $R^2$ | .137 | .120 |
| **Adjusted $R^2$** | .128 | .110 |
| F Value of Model | ·137*** | .120*** |
| F Value of Model | 14.739*** | 12.576*** |

**Independent Variables**: Intellectual Capital, Entrepreneurial Orientation
**Dependent Variables**: Innovation Performance, Financial Performance
*p<0,05 **p<0,01 ***p<0,001

# DISCUSSION AND CONCLUSIONS

The goal of the study is to understand the effect of entrepreneurial orientation on organizational performance. In this relationship, the intellectual capital is taken as an antecedent of entrepreneurial orientation to explore the impact of organizational knowledge-resource on entrepreneurial orientation.

Intellectual capital is the knowledge-resources that provide sustainable competitive advantage to the firms. Prior empirical studies have been found that human, structural and customer capital have a significant positive effect on organization performance, thus the results of this research also shows the positive relationship between the intellectual capital and the financial and the innovation performance in Turkish Companies.

Recent conceptual models suggest that entrepreneurial orientation is dependent upon the acquisition, integration and exploitation of knowledge (Hayton, 2002). Last decade strategy researches consistently suggest that internal organizational factors, in particular, play a major role in encouraging corporate entrepreneurship (Covin and Slevin, 1991). Academics point out that the factors in the external environment and within the organization interacts, challenging the managers to respond creatively and act in innovative ways. Then it is reasonable to expect that organizational knowledge is an important resource that supports a firm's entrepreneurial behavior. This study's empirical result is consistent with arguments. According to the multiple stage regression analysis, entrepreneurial orientation was found as a mediating variable between intellectual capital and organizational performance. In theoretical framework, EO scholars, suggest that a positive relationship between entrepreneurial orientation and performance can be expected because entrepreneurship creates and leverage knowledge within the firms. Intellectual capital, feed the entrepreneurial process knowledge which is the basis source of entrepreneurial initiatives (Floyd and Wooldridge, 1999).

# REFERENCES


- Antoncic, B. ve Hisrich, R.D., (2001) "Intrapreneurship: Construct Refinement and Cross-Cultural Validation," *Journal of Business Venturing,* 16, 495–527.
- Antoncic, B. ve Hisrich, R.D., (2004) "Corporate Entrepreneurship Contingencies and Organizational Wealth Creation," *Journal of Management Development*, 23(6), 518-550.
- Barney, J.B. (1991), Firm Resource and Sustained Competitive Advantage, *Journal of Management* ,17(1), 99-120.
- Baron, M. R. & Kenny, D. A. (1986). The Moderator-Mediator Variable Distinction in Social Psychological Research: Conceptual, Strategic, and Statistical Considerations. *Journal of Peronality and Social Psychology*, 51 (6), 1173–1182.
- Bontis N., Chua, W. and S. Richardson. (2000). Intellectual Capital and the Nature of Business in Malaysia, *Journal of Intellectual Capital*, 1(1), pp.85-100.
- Bontis N., Keow W. C. and Richardson S. (2000), Intellectual capital and business performance in Malaysian industries , *Journal of Intellectual Capita,* 1.
- Bontis, N., (1999) Managing Organizational Knowledge by Diagnosing Intellectual Capital: Framing and Advancing the State of the Field, *International Journal of Technology Management*, 18.
- Bontis, N., (2001) Assesing Knowledge Assets: A Review of the Models Used to Mesaure Intellectual Capital , *International Journal of Management Reviews*, 3( 1) .
- Bontis, N., (2004) National Intellectual Capital Index: A United Nations Initiative for the Arab Region, *Journal of Intellectual Capital,* 5(1).
- Bontis, N., Keow, W.C.C., Richardson, S., (2002) Intellectual Capital and Business Performance in Malaysian Industries, *Journal of Intellectual Capital*,1(1).
- Bontis, Nick and Jac Fitz-enz. (2002) Intellectual Capital ROI: A causal map of human capital antecedents and consequents, *Journal of Intellectual Capital*, 3( 3), pp.223-247
- Bontis, Nick. (1998). Intellectual Capital: An exploratory study that develops measures and models, *Management Decision*, 36(2), pp.63-76
- Brooking A.(1997), The Management of Intellectual Capital, *Long Range Planning*, 30(3), pp.364-365.
- Chang A and Tseng C. (2005), Building customer capital through relationship marketing activities: The case of Twainese multilevel marketing companies, *Journal of Intellectual Capital,* . 6(2), pg. 253-266.
- Chang A. & Tseng C., (2005), Building customer capital through relationship marketing activities: The case of Tawanese multilevel marketing companies, *Journal of Intellectual Capital,* 6(2), pp. 253-266.
- Choo, C. W. and Bontis N. (2002), **The Strategic Management of Intellectual Capital Organizational Knowledge,** Oxford University Pres, NewYork, NY.
- Covin, J.G. ve Slevin, D.P. (1991). "A conceptual Model of Entrepreneurship as Firm Behavior,". *Entrepreneurship Theory and Practice* 16(1):7-25.
- Damanpour, F. (1991). "The Adoption of Technological, Administrative, and Ancillary Innovations: Impact of Organizational Factors," *Journal of Management,* 13(4), 675-688.
- Dess G. & Lumpkin G., Covin G.(1997), Entrepreuneurail strategy making and firm performance: tests of contingency and configurational model. *Strategic Management Journal*, 18(9), pp.677-95.
- Dierickx I. and Cool K.(1989).Assets stock accumulation and sustainability of competitive advantage. *Management Science* 35, pp.1504-1511

- Edvinsson, L. and Malone, M. S. (1997). Intellectual Capital: Realizing tour Company's True Value by Finding its Hidden Brainpower. New York: Harper Business.
- Floyd, S. W., & Wooldridge, B. 1999. Knowledge creation and social networks in corporate entrepreneurship: The renewal of organizational capability. *Entrepreneurship Theory and Practice,* 23(3): 123-143,.
- Guth, W.D. ve Ginsberg, A. (1990). “Guest Editors’ Introduction: Corporate Entrepreneurship,” *Strategic Management Journal,* Summer, 11, 5-15
- Hall R.(1992), The strategic analysis of intangible resources, Strategic Management Journal, 13, pp.371-386.
- Hayton C. J.(2005), Promoting corporate entrepreneurship through human resource management practices: A review of empirical research, Human *Resource Management Review*, 15 ss. 21–41.
- Hayton J.C (2002), The effect of intellectual capital on EO in high technology new venture
- http://www.sveiby.com/Portals/0/articles/IntellectualCapital.html
- Hudson W.(1993), **Intellectual Capital: How to Build It, Enhance It, Use It**. New York: Wiley
- Itami H.,(1987), **Mobilizing Invisible Assets**. Boston: Harvard University Press.
- Jantunen A., Puumalaınen K. Saarenketo S., Kylaheıko K. (2005),Entrepreneurial Orientation, Dynamic Capabilities and International Performance,*Journal of International Entrepreneurship* 3, pp.223–243,
- Lumpkin, G.T. & Dess, G.G. (1996).Clarifying the entrepreneurial orientation construct and linking it to performance. *The Academy of Management Review.* 21(1), pp.135-172.
- Marr B., and Schimuma G., (2001), **Measuring And Managing Intellectual Capital And Knowledge Assets In New Economy Organizations**. Handbook of Performance Measurement, London.
- Marr B.; Ross G. (2005), *A Strategy Perspective on Intellectual Capital* Perspective on Intellectual Capital.
- Marr, B., Gupta, O., Pike, S., Ross, G., (2003), Intellctual Capital and Knowledge Management Effectiveness”, Management Decision, 41(8).
- Miller, D., (1983), The correlates of entrepreneurship in three types of firms, *Management. Science*. 29, pp.770–791.
- Morris, M.H. and Sexton, D.L. (1996). The concept of entrepreneurial intensity: Implications for company performance, *Journal of Business Research*, Vol. 36, No. 1, 5-13.
- Nahapiet, J. & S.Ghoshal. (1998). Social capital, Intellectual capital and the organizational Advantage, *Academy Of Management Review* 23(2), pp.242-266.
- Naman, J. L. ve Slevin, D. P. (1993). “Entrepreneurship and the Concept of Fit: A Model and Empirical Tests,” *Strategic Management Journal,* 14, 137–154.
- Narver, John C. and Stanley F. Slater. (1990), The Effect of a Market Orientation on Business Profitability, *Journal of Marketing,* 54, pp.20-35.
- Orhan Küçük (2005), *Girişimcilik ve Küçük İşletme Yönetimi,* Seçkin Yayıncılık, Ankara 2ed.
- Patricia Ordonez de Pablos (2002), Evidence of intellectual capital measurement from Asia, Europe, and the Middle East, *Journal of Intellectual Capital,*3(3), pp. 287-302.
- Pennings J. M. & Harianto F.(1992), Technological networking and innovation implementation, *Organization Science* 3 (3), pp.356-383.
- Skandia (1996), **Power of Innovation: Intellectual Capital Interim** Annual Report Supplement.
- Stewart, T.A., (1997), **Intellectual Capital: The New Wealth of Organizations**, New York: Doubleday.
- Storey J. (1995), HRM: still marching on, or marching out?, in Storey J.(ed.) Human Resource Management: A Critical Text. London: Routledge.
- Subramaniam m. & Youndt M.A. (2005) The Influence of Intellectual Capital on the Types of Innovative Capabilities *The Academy Of Management Journal*
- Subramaniam, M. and Venkatraman, N. (2001). “Determinants of Transnational New Product Development Capability: Testing the Influence of Transferring and Deploying Tacit Overseas Knowledge”, Strategic Management Journal, 22, 359-378.
- Teece, D. J. (2000), Managing **Intellectual Capital: Organizational Strategic, and Policy Dimentions**, Oxford University Press, Oxford.
- Tsai, W. and Ghoshal, S. (1998), Social capital and value creation: the role of ingraining networks, *Academy of Management Journal,* 41, pp.464-478
- Tsan W., & Chang C. ,(2005), Intellectual capital system interaction in Taiwan, *Journal of Intellectual Capital,* 6 (2), pp. 285-298.
- Wiklund, J. and Shepherd D., (2003),Knowledge-Based Resources, Entrepreneurial Orientation, and the Performance of Small and Medium-Sized Businesses, *Strategic Management Journal* **24** (13),pp.1307–1314.

- Wiklund, J. ve Shepherd, D. (2005). “Entrepreneurial orientation and small business performance: a configurational approach,” *Journal of Business Venturing,* 20, 71–91.
- Wright P.M., McMahan G.C., and McWilliams A.,(1994), Human resources and sustained competitive advantage: a resource-based perspective, *International Journal of Human Resource Management* 5(2), pp.301-326.
- Youndt, M.; Subramaniam, M.; Snell, S. A.(2004), Intellectual capital profiles: An examination of investments and returns, *Journal of Management Studies,* 41(2), pp. 335-361.
- Zahra, S.A. (1991). “Predictors and financial outcomes of corporate entrepreneurship: An exploratory study,” *Journal of Business Venturing*, 6(4), 259–285.
- Zahra, S.A., Ireland, R.D., Gutierrez, I. ve Hitt, M.A. (2000). Privatization and Entrepreneurial Transformation: Emerging Issues and a Future Research Agenda, *Academy of Management Review*, 25(3), 509-524.
- Zahra, S.A., Nielsen, A.P., and Bogner, W.C., (1999). Corporate entrepreneurship, knowledge, and competence development, *Entrepreneurship Theory Practice,* 23 (3), 169–190.
- Zander, U. and Kogut B.(1995), Knowledge and the speed of transfer and imitation of organizational abilities: an empirical test, *Organization Science* 6(1), pp.76-92.
- Zott, C. (2003), Dynamic Capabilities and the Emergence of Intraindustry Differential Firm Performance: Insights from a Simulation Study, *Strategic Management Journal*, 24(2), pp. 97-125.

# SOCIAL ENTREPRENEURSHIP: IS IT VALID FOR CORPORATIONS?

**Senem Besler -Aytül A. Özdemir**
**Anadolu University, Turkey**

**Muammer Sarıkaya**
**Kafkas University, Turkey**

## ABSTRACT

*In recent years, social entrepreneurship, a sub-discipline within the field of entrepreneurship, has received increasing attention from entrepreneurship scholars. At the same time, scholars and managers discuss how to enhance the effectiveness of extant corporate social responsibility activities while facing with the new challenges of globalization and high competition. Under this context, there is a theoretical controversy in the extant literature where the key concepts of entrepreneurship, social entrepreneurship, commercial entrepreneurship and corporate social responsibility intersect. The main objective of this paper is to discuss the concept of social entrepreneurship and try to draw a social entrepreneurship typology that shows the concept can also be placed in for-profit corporations. Corporations can/have to pursue social entrepreneurship motives and activities. It is so important to mention that entrepreneurship in business sector has a social aspect too. To survive, corporations have to leave their traditional societal investments and follow investments which could provide the most added values to the society and corporations. According to this assumption, this paper suggests corporate intrapreneurship and partnership as one of the most beneficial methods to move from traditional social responsible activities to corporate social innovation perspective.*

## INTRODUCTION

Social entrepreneurship is a new and rapidly growing field of application in practice. However, this concept has an outstanding place and field of application mostly in the third sector which brings the cause that social entrepreneurship is valid only in the third sector. Additionally, both the increase in the number of non-profit organizations and some changes taking place in the competition environment faced by these organizations over the recent years have increased the interest in social entrepreneurship. Increasing needs of the society and the demands to meet these needs displayed differences throughout the history and the socio-political conditions of every period caused the civil society requirements to be re-positioned. Increasing demands of societies from these organizations and obligations/missions attributed to these organizations cause the enlargement of impact area and boundaries of third sector. Today, on the other hand, the boundaries have become blurred. The environment in which only the non-profit organizations operate has turned into an environment that also includes the state and commercial enterprises. The state, commercial and social enterprises have to fulfill the mission of social value and make a collaborative impact concerning societal development in the modern world. This situation in turn, has contributed to the emergence of a series of social tendencies, organizational structure, and individual initiatives gathered under a generic umbrella with the term social entrepreneurship (Roper and Cheney, 2005; 97).

Despite this rapid development in practice, the literature regarding the field is seen to be still at the stage of development. The number of interdisciplinary studies is quite limited in social entrepreneurship literature and the concept is questioned more in non-profit marketing literature. The dispersed nature of literature and its lack of a consistent theoretical framework have caused its conceptual basis to become blurred as well. However, a consensus has also been created in literature in terms of how important the matter of understanding social entrepreneurship and social entrepreneurs is (Cooperrider and Pasmore, 1991; Dees, 1998). Therefore, there is a great need for the development of theoretical structure towards social entrepreneurship and for contributions to be made to theory and practice. We believe that our study will serve this purpose.

To draw a conceptual framework underlying the concept of social entrepreneurship, this paper is organized as follows. First, we briefly review the literature regarding social entrepreneurship. Second, we incorporate social entrepreneurship into our theoretical analyses and discuss its moderating role in the performance of corporate social responsibility. Finally, we discuss some sort of new ways for corporations to move from corporate philanthropy to social entrepreneurship.

## Social Entrepreneurship in Literature

Social entrepreneurship is a developing concept of which consensus about the definition cannot yet be reached. However, the concept is tried to be questioned every day by different disciplines. Thus, different approaches towards social entrepreneurship in literature have caused the concept to be defined in different ways. Literature review provides us to summarize these approaches in three different groups:

The approaches that are included within the first group and that constitute a major part of the literature related to social entrepreneurship have developed in the field of non-profit organizations. Social entrepreneurship is perceived and emphasized as a concept peculiar to non-profit organizations. The concept of **social entrepreneurship** is defined as development of innovative approaches by non-profit organizations to earn an income. The aim with such an approach is to enable non-profit sectors to acquire commercial expertise and market based skills (Reis, 1999; Thompson, 2002). However, we would like to clarify one point here. It is not correct to accept that every non-profit organization has a social entrepreneurship purpose. There may be some with and some without a social entrepreneurship quality among these organizations. Organizations operating as social entrepreneurs may differentiate from other non-profit organizations with the strategic decisions they take and their visions as well as the behavioral characteristics they display against the reactions of the society (Weerawardena and Mort, 2006; 22). For this reason, we believe that not all non-profit organizations should be perceived as social entrepreneur organizations. The main criteria to distinguish non-profit from social entrepreneurship is that the latter one creates the transformation of society through the activities it organizes or display. For example, in Turkey, although there are so many non-profits in practice, organizations making a mark on society and engaging public/private sectors' attention are so limited.
When we look at the approaches included within the second group in literature, on the other hand, profit-making social enterprises are considered as social entrepreneurs (Wallace, 1999). Enterprises having the purpose of both making profit and creating social impact are classified as social entrepreneurs whether they are non-governmental organizations or profit-making private enterprises (Dees and Anderson, 2003; Emerson and Twersky, 1996). In this field, social entrepreneurship is defined as performing socially oriented innovative activities.

According to the approach included in the third group, on the other hand, social responsibility activities realized by profit-making companies, particularly through inter-sectoral cooperation, are evaluated within the framework of social entrepreneurship (Sagawa and Segal, 2002). How any case of non-profit cannot be called as social entrepreneurship, also any case of social responsibility cannot be called as social entrepreneurship. In this paper, we focus on the main distinctions between social entrepreneurship and social responsibility.

Well then, how are we going to define social entrepreneurship in this study or who are we going to consider as social entrepreneurs? In fact, it is really difficult to answer this question. We see that the conceptual basis of this matter has not either been properly determined in literature yet. However, we will try to conceptualize social entrepreneurship with the bases we have determined and adopted by drawing upon the studies in literature. Within this context, we believe that it would be more proper to draw on the researches included in the second group. Social entrepreneurship in this study may emerge as a result of the activities of profit-making companies towards directly creating a social transformation in the society. Even though the existing literature is focused on the non-profit nature of social entrepreneurship activities, profit making is also an element that can be included in social entrepreneurship.

This definition of social entrepreneurship, which we take as reference, can be examined according to three different variables that would provide guidance in understanding and conceptualizing the concept:
1) The fact of **creating social value** lies under social entrepreneurship. As asserted by many researchers, social mission is distinctive and central to social entrepreneur organizations (Dees, 1998; Mort et al., 2003). Just as a commercial enterprise, which aims to create an outstanding value for the customer, the basic aim of a social enterprise is to create an outstanding social value for its own customers (Dees, 1998). The ability of a social entrepreneur to draw resources (capital, labor, equipment, etc.) towards itself in a competitive market is an indication that it can utilize such resources more efficiently against its competitors. Social entrepreneurship is placing a social problem in the center and being able to mobilize the resources required

for dealing with this problem in an efficient manner. In addition, it has also been stated that social entrepreneurship enables an enterprise to obtain sustainable competitive advantage and thus, to effectuate a mission (Weerawardena and Sullivan Mort, 2001; 22). Consequently, resources are required to be brought together in a way to create social value in social entrepreneurship. Resources are used in looking for and finding opportunities to meet a social need or to create a social transformation. This does not necessarily mean that a new corporation will be created. Producing a new product or service is also sufficient to create social value.

2) Well then, how will this social value be created? Another fact that lies under social entrepreneurship is **innovation**. Many researchers emphasize the role of innovation in a social entrepreneur organization (Borins, 2000). Again, in researches conducted, it has been determined that innovation, proactiveness and risk taking constituted the center of social entrepreneurship (Prabhu 1998; Mort et al., 2003).

3) Along with the extant literature, many popular definitions of social entrepreneurship have focused on social initiatives in non-profit sectors. Such a limitation contradicts with our understanding of social entrepreneurship. Therefore, social entrepreneurship may also exist in all sectors, whether they are non-profit, commercial, or public. The definition set forth by Austin and Reficco (2009) emphasize this fact. Areas of interest for social entrepreneurship may differentiate and they in fact continue to increasingly broaden. For this reason, social entrepreneurship must be conceptualized in a way to include all fields. Enterprises are ruthlessly competing with each other in today's competition environment where the industrial boundaries have become blurred. This environment directly affects not only commercial enterprises but also all private and public non-profit enterprises. Therefore, we believe that it would be more appropriate to conceptualize social entrepreneurship within a competition environment that encompasses all organizations.

Well then, who will the social entrepreneurs be? If we take the definition we have accepted above as basis, social entrepreneurs may be the managers of non-profit organizations as well as those of the enterprises in other fields (Roper and Cheney, 2005; 99). From this point of view, Dart's (2004) definition of social entrepreneurs has been taken as basis in defining social entrepreneurs. According to Dart, social entrepreneurs are the agents of transformation within the social sector and they bear the following characteristics (Dart, 2004; 414):

- Having a mission of creating and sustaining social value,
- Seeing the new opportunities that would serve such mission and following them decisively,
- Being continuously involved with the process of innovation, harmony, and learning,
- Operating without being limited by the existing resources at hand,
- Having a greater sense of responsibility for the stakeholders served and the outputs created.

To sum up, who see and realize the opportunities that purse social value creation in a innovative way and have a sense of responsibility for stakeholders can be defined as social entrepreneurs, regardless of the sector they display in.

## THE LINK BETWEEN SOCIAL ENTREPRENURSHIP AND COMMERCIAL CORPORATIONS

Accepting that social entrepreneurship is only valid for non-profit organizations and it consists of the social values created solely by these organizations constitute one of the biggest obstacles hindering the development of the concept of social entrepreneurship. Profit-making organizations, that is, companies operating in the private sector also create social value and they are obliged to do so. Otherwise, as also pointed out by the legitimacy theory, organizations would have no chance of survival within the environment they operate in. We also encounter social value creation as a consequence of economic activities; having a drive to make profit does not mean that such activity will not create social value. The point that should be emphasized within this context is related with the content of the "social" phenomenon. What is meant by "social" must be clearly specified in this discussion. As stated by Tan et al. (2005), each entrepreneurial activity includes the society in one way or another; however, we cannot say that every initiative is social (Tan, Williams and Tan, 2005; 353). Social needs differ depending on persons and institutions. A criterion that can be used at this point is sustainable development (Weerawardena and Mort, 2001; Seelos and Mair, 2004). In order for an activity to be considered as "social", it must meet the requirement of sustainable development. Creation of sustainable development is not a phenomenon that can be realized by non-profit organizations alone; sustainable development can be created with the joint efforts of the private sector, the public sector, and non-governmental organizations. For example, to be an effective social entrepreneurship in the third sector, third sector organizations need sustainable fund sources and a professional management. Private organizations can provide social value and enlargement their social mission through helping and supporting third sector organizations. Entrepreneurship mostly comes along with the private sector and the concept includes innovativeness, pro-activeness and taking a risk. Successful entrepreneurs can display their same qualifications under the development of social value.

## ARE THEY SAME CONCEPTS : SOCIAL ENTREPRENEURSHIP AND CORPORATE SOCIAL RESPONSIBILITY?

When we examine literature, we see that the main discussions concentrate on two axes: The first one of these is that social entrepreneurship, the basic aim of which is to create social value, is not valid for private companies, whose main aim is to earn money. Social entrepreneurship may only take place within the field of activity of non-profit organizations (Dart, 2004). The second, on the other hand, is that many writers announce companies that perform corporate social responsibility activities as social entrepreneurs (Sagawa and Segal, 2002). In this part of the study, we will try to find an answer to the two discussions mentioned above with the model we will present.

## Concept of Corporate Social Responsibility

Corporate social responsibility is among the main topics taken up within the business world in recent years. It is possible to say that there are two basic reasons for this. Firstly, parallel with the increasing role of enterprises within the society and the ever-increasing social consciousness, corporate social responsibility practices of enterprises have become an obligation. Secondly, corporate social responsibility is one of the matters applied to by enterprises over the recent years in terms of competitive advantage. This is because, the corporate social responsibility practices that are realized have a significant influence on the interest or lack of interest of stakeholders in enterprises.

The importance gained by corporate social responsibility has also caused an increase in the studies performed with this regard in literature. Studies related to corporate social responsibility in its current meaning, which started with Howard Bowen (1953), have continued until today. There is no definition of the concept, on which everybody agrees. This may be explained with the variant structure of corporate social responsibility as well as the different approaches to corporate social responsibility. When the studies conducted are examined, it can be seen that corporate social responsibility is basically addressed within the framework of three approaches. These are the shareholder approach, the stakeholder approach, and the social approach. The shareholder approach emphasizes that enterprises must focus on profit making as stipulated by legal limitations. This approach argues that the principal responsibility is the responsibility towards the shareholders. The stakeholder approach, on the other hand, point out that the survival of enterprises depends on their ability to efficiently manage their relationships with their stakeholders and that they are responsible before all their stakeholders. Social approach evaluates corporate social responsibility within a broader sense and argues that an enterprise is responsible before the entire society, whether it has stakeholders or not.

These different approaches also cause differences in practices. For instance, when we look at the websites of the largest enterprises of Turkey, even though most of these enterprises include a link related to social responsibility in their websites, this matter is addressed with different concepts. Again, it can be noted that there are also differences in the practices mentioned under these headings. In addition, one of the main mistakes that are made is the use of the concept as a synonym for social projects. It is seen that the concept is taken up within this framework in many studies conducted in Turkey. However, it is quite difficult to consider enterprises, which only take part in social projects and fail to perform their other responsibilities, as a responsible enterprise.

The differences of approach experienced with regard to corporate social responsibility and the problems encountered in practices have caused enterprises to head towards social entrepreneurship, which has gained importance over the past years. Corporate social businesses are large-scale activities that are undertaken by a corporation in order to support social purposes and to fulfill its corporate social responsibility obligations (Kotler and Lee, 2006; 3).

Basically, social entrepreneurship has been continuing to operate in the non-profit sector for a long time and considered as the practices of these organizations. This is because, these social movement organizations conform to the definition of contemporary entrepreneurs, they are established with the ambition, insight, and creative works of people, and they continue their activities with this understanding all around the world (Roper and Cheney, 2005; 97-98).

With a long-termed perspective, social and economic purposes do not contradict with each other in essence, on the contrary, they are interconnected. For instance, protecting the environment is not only for the benefit of the society but also for the benefit of the enterprise. This is because preventing environmental pollution helps in the more productive use of resources and the production of goods valued by consumers. Improving social conditions in developing countries allows for the creation of a greater number of productive regions for the activities of the enterprise as well as new markets for the products (Porter and Kramer, 2002; 59).

Today, enterprises support charitable activities through their corporate powers. Apart from financial aids, they also provide management consultancy, technology and communication support, as well as teams of volunteer workers to non-governmental organizations. In addition, they provide funds for these businesses not only from their charity budgets but also from the budgets of their business units such as marketing and human resources. Enterprises that become corporate citizens in this manner try to associate their profit making strategies with the welfare of the society and find ways to manage all the components of the enterprise on a socially relevant route (Smith, 1994; 105-107).

A major chaos arises in literature because of the assumption that "companies that perform corporate social responsibility activities are social entrepreneurs at the same time." Social entrepreneurship is a new form of social responsibility, but will be extremely wrong to consider it as a concept that would replace social responsibility. There is a supporting and reciprocal relationship between social responsibility and social entrepreneurship; profit-making companies' being social entrepreneurs will ensure that corporate social responsibility is managed in a more strategic and efficient manner. Austin and Reficco (2009; 1) draw a picture of the relationship of these two concepts such: "Social entrepreneurship is a process aimed at enabling business to develop more advanced and powerful forms of Corporate Social Responsibility". The changing notion of Corporate Social Responsibility (CSR) has brought about new practices in large corporate organizations, which are increasingly engaging with social entrepreneurship activity (Chell, Karatas-Ozkan and Nicolopoulou, 2005;5). Social entrepreneurship has become a new and more beneficial way of social participation for companies.

Social entrepreneurs may discover or create opportunities and they may perform businesses towards making profit, creating wealth, and balancing social and economic obligations. Such social businesses may be created by independent enterprises besides companies. Profit-making and non-profit social businesses may be the locomotive of economic and social development on global scale since they create services and build up the necessary institutions and infrastructure for development (Zahra et al., 2008; 118).

However, when we look at corporate social responsibility practices, we can see that they a reactive to a large extent. Actions are taken with the responsibility map determined within the economic, legal, and ethical limits of the society in which the activities are performed. When we look at voluntary activities, on the other hand, it can be observed that charitable activities are performed in compliance with the policies and fields determined by the state, especially in our country. However, social entrepreneurship is a transformation created by companies within the entirely unique society. Now, some companies are known by the social entrepreneurship activities performed by them. Such an approach provides a longer termed and more effective feedback in societies, the education and development levels of which are increasing, and it is of great importance in terms of the sustainability of companies.

## SOCIAL ENTREPRENEURSHIP IS VALID FOR CORPORATIONS

In recent years it is possible to encounter with the examples of social entrepreneurship of corporations. Certain criteria has been tried to be established in this study based on the social entrepreneurship examples in literature in order to determine the activities of companies, by which they can be considered social entrepreneurs.

We have examined some of the companies that operate in the private sector and are evaluated within the scope of social entrepreneurship and we have emphasized examples, which we frequently encounter. For instance Ben&Jerry's provides free of charge franchising to non-governmental organizations with its "PartnerShop" program (Naumes and et al., 2002; Peredo and McLean, 2006). When we look at mission definitions on web pages, we have seen that they made three different mission definitions: the Social Mission; the Product Mission, and the Economic Mission. They have defined their social mission as follows: As seen from this mission definition, making profit has been considered equal with the sensitivity for and the interest in the environment and social matters.

Another example comes forth as Th!nk Global, which is a Norwegian. Owned by a group of clean-tech investors, it is clearly set up to create profit. However, the environmental goal of saving the climate fossil fuels is the most important elements of its business model (CSR-Driven Innovation Report).

BancoSol is a commercial bank devoted to the provision of financial services for the poor. Located in Bolivia, the bank was founded building on international donations; but it has been operating at a profit since its foundation in 1992. AgraQuest produces and commercializes pesticide products from naturally occurring organisms. Citysoft is a software company that sells "community enterprise," an integrated web-based platform designed for non-profit and for-profit, socially responsible organizations. Finally, Ripple Effects is also a software company. It produces software designed to enable people to learn effectively (Dorado, 2006; 325). For-profit corporation does not mean that such company is not a social entrepreneur; the product or service provided by that company must meet a social requirement and contribute to the environment The important point here is that the strategy to obtain an income is directly connected with the social impact objective.

An example from Turkey, on the other hand, is Hey Tekstil, which received the social entrepreneurship award from the Schwab Foundation in 2008. According to the Foundation, which does not provide financial support, however, aims to bring social entrepreneurs together; social entrepreneurship is "application of practical, innovative, and market oriented approaches towards changing the conditions that marginalize people and push them to poverty as opposed to corporate social responsibility and charitable businesses that do not address the root of poverty". It is written that Hey Tekstil deserved this award with the factories it opened in Anatolia for women and young people.

In light of all this information, we have determined the elements that make companies social entrepreneurs as follows:

*Firstly,* the missions of companies must include creation of social value. Being a social entrepreneur requires long-term commitment, it is not an entrepreneurship that is performed for a certain period of time, on a temporary basis, or because it is in fashion (Shaw and Carter, 2007; 421). Here the priority and order of social values and economic values may change; however, the important thing is that social values must be central to the business management model.
*Secondly,* it is quite difficult to evaluate repeating social projects within the scope of social entrepreneurship. As also seen in the definition of social entrepreneurship, bringing resources together and managing them in an innovative manner is extremely important in organizing activities. Here, the use of the corporate social innovation concept will enable a better understanding of this criterion. The concept of social innovation was first used by Kanter (1999). Companies both create a new market value and contribute to the meeting of a social requirement by meeting a requirement of the society that has not been met before.
*A third and important criterion*, on the other hand, is that the corporation must be willing to accept a risk of profit reduction while designing projects that would create social value (Peredo and McLean, 2006, 62).
*A fourth criterion* requires that an activity must create a measurable transformation in the society in order for such activity to be considered as a social entrepreneurship activity. Sustainability, social improvement and social change are the essential concerns of social entrepreneurship (Weerawardena and Mort, 2001). Sustainable approach to systemic change that resolves social failures is the main impact of social entrepreneurship (Nicholls, 2005; 5).

The corporations meet the criteria mentioned above can be a leader in the competitive environment and have a sustainable image through the transformation they create in society, just like in their profit-based entrepreneurship.

When all the examples and criteria that are examined are combined, the model that comes forth is as follows:

Figure 1: Social Mission/Profit Mission Continuum

| | | | |
|---|---|---|---|
| Profit: Goal<br><br>Profit: Means | Socially Responsible Business<br><br>(II) | Social Purpose Business<br><br>(III) | |
| Social | | Non-profit Organizations<br><br>(I) | Social Impact: Means<br>Impact: Goal |

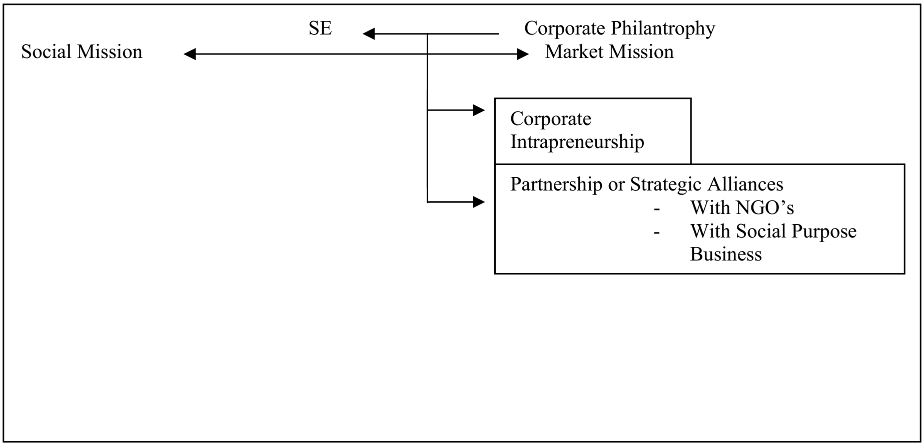
*Source: Formed by the authors.*

In social entrepreneurship literature, while the main purpose of the organizations given in the 1st Box is creating social value, making profit is only an instrument. Non-governmental organizations, which are engaged in small income generating activities and which try to finance its social activities with grants and membership fees, are included in this box. The 2nd Box, on the other hand, represents the organizations where the primary objective is making profit and creation social value is only used as an instrument in this process. The point that is essentially focused on in this study is that profit-making companies in the private sector can be included in the 3rd Box. Even though there are examples of these types of companies in practice, their number is very few. Social purpose business comes forth as the point to which companies are brought by corporate social innovation. The examples mentioned above are evaluated in this box. The corporation voluntarily creates social value within its business management model. The success of the corporation depends on its achievement of both financial and social objectives. Dees and Andersen (2002) established a social values chain based on Porter's chain of values and evaluated buying products from suppliers that do not harm the environment or that are disadvantaged, employing disadvantaged individuals (ex-convicts, drug addicts, disabled people), or products manufactured or services provided with the aim of meeting a social requirement among social purpose business activities within this chain (Dees and Andersen, 2002; 3-5).

Of course, it is possible to switch among the boxes with utilizing some methods as seen in Figure 2. Since we say that social responsibility and social entrepreneurship are not the same things and that social entrepreneurship can also be valid for profit-making private companies, there are certain mechanisms that would assist companies in directing themselves from repeating charitable activities towards social entrepreneurship.

When we look at the practices of companies, we see activities performed in the dimension of charitable endowment more frequently (Austin, 2000; 71). Generally, using products that do not harm the environment, making donations, or providing financial support or being sponsors by companies do not mean that such companies would be social entrepreneurs. Corporate philanthropy is a limited activity that benefits only a certain part of the society. And these kinds of activities are mentioned with the names of corporations' owner. Supporting social entrepreneurship activities do not make companies social entrepreneurs; they should undertake responsibility on activities, organize innovative activities, in other words, they should bear all the elements included in the definition of entrepreneurship. To put it differently, charitable endowment remains inadequate in meeting corporate social entrepreneurship. In creating social values, the corporation remains quite passive in businesses performed through charitable activities. It is a structuring where the interaction between the company and the society is very limited. Here, what needs to be answered is putting forth the mechanisms that enable transition between corporate social responsibility and corporate social entrepreneurship. One of these is corporation intrapreneurship, while the other is strategic alliances.

Figure 2: From Corporate Philantrophy to Social Entrepreneurship




*Source:Formed by the authors.*

***Corporation Intrapreneurship:*** Corporations need to be entrepreneurial to see the opportunities which have the potential to create social value (Peredo and McLean, 2006). Social entrepreneurship is the process of creating social value to pursue opportunities by combining resources in new ways (Seelos and Mair, 2004; 8; Mair and Noboa, 2003; 2). Moving the company in this direction needs individuals in the company who focus on fostering innovative approaches to social issues (Austin and Reficco, 2009; 5). This is where a unit or department is created within the company and corporate social responsibility activities are organized by this unit. The control of the company is a little higher. It is possible for the company to realize a series of activities that are suitable for its strategic goals and skills. However, a negative aspect of this type of activity is that it causes the organization to organize social responsibility activities only within its field of activity. It is difficult for the company to realize social responsibility concerning the social problems of the society in different fields.

***Partnership:*** Large companies encounter new models that would create social participation. This concept, which is also included in literature as strategic alliances, cause companies to get involved in social activities that require innovation and joint participation proactively as a result of their partnership with non-profit companies. The most important point lying under success is the degree of commitment of top management to the shared purpose. However, the prevalent form of activity at this point is cause related marketing. A more structured and even strategic form of cooperation with non-profit organizations is the cause-related marketing. It is a more commercial and marketing partnership, in which a non-profit organization provides or leases its logo to a commercial product, or expresses its direct recommendation of a corporation. Business on the contrary heavily promotes this social support in its marketing activities and adds thus a social dimension or value to its products (Wymer and Samu, 2003; 12-13). Porter and Kramer (2002) also labeled cause-related marketing as one of the earliest practice of strategic philanthropy; but they criticized the concept because of its being deficient to fulfill both social and economic gain. Its focus on publicity rather than social impact represses the concept's being strategic (Porter and Kramer, 2002; 6). Here, the responsibilities of companies on social problems are quite passive and they may not create much added value for companies in directing towards social entrepreneurship. A business-nonprofit joint venture is the new way of partnering where partners are trying collectively to achieve mutually desirable objectives (Wymer and Samu, 2003; 15). According to Austin (2000), joint venture represents the highest strategic level of collaboration. This kind of collaboration provides a mission centered philanthropy and intensive interaction level (Austin, 2000; 72).

It is important to emphasize that not only non-profits, but also social purpose ventures in non-profit sector who pursue market-based strategies and are managed as a commercial or business-like (Dart, 2004; 414), are the potential partner for organizations in strategic joint ventures (Tracey, Phillips and Haugh, 2005; 332-333).

In strategic corporate social responsibility, non-governmental organizations and companies act jointly to solve a social problem by taking a certain degree of responsibility and checking the results; in this manner, companies will have the opportunity to learn the requirements of the society more closely and most important of all, the interaction between the company and the society will increase. In this process, we see both non-profit non-governmental organizations and social businesses that perform profit-making activities as the partners of the company. Taking part in these types of cooperation will enable companies to be involved in efficient corporate social responsibility activities while increasing their skills and capacities to become a social entrepreneur. They will learn to use their resources for efficiently for corporate innovation and their opportunities to discover new markets for social needs will increase.

# CONCLUSION

Social responsibility is a continuously developing subject that brings along different approaches in both academic and practice fields. However, a chaos is observed to have emerged, particularly with the subject gaining more importance over the recent years. We can see that companies stating that they are socially responsible and declaring the activities they perform in this context realize practices that are different from each other. In addition, besides the incomprehensibility that is being experienced, different approaches are also displayed in literature. The subject matter is addressed under the headings of social responsibility, corporate social responsibility, corporate responsibility, strategic corporate social responsibility, strategic charity, corporate charity, corporate social performance, corporate social sensitivity, corporate reputation, and even sponsorship. At this point, it has become quite difficult to define a socially responsible corporation.

The concept of social entrepreneurship allows a thick line to be drawn among the practices of companies. The concept that requires social transformation and needs a social mission has been increasingly gaining importance in this sense over the recent years. It is seen that social entrepreneurship is confused with the above-mentioned concepts, primarily being social responsibility. However, social entrepreneurship emphasizes a social innovation and its sustainability just as the innovation created by commercial entrepreneurship. This, on the other hand, is a result of the broadening by changing dimension of the mission carried by companies in today’s society. Now, only commercial entrepreneurship is not enough and just as the two wings of a bird, social entrepreneurship is also necessary.

Within this context, by going beyond the acceptable understanding in practice and literature, we would like to state in this study that social entrepreneurship is also valid for profit-making companies. Profit making does not mean that an activity cannot be evaluated within social entrepreneurship; with this aim, we have tried to shed light on the activities that should be evaluated within the scope of social entrepreneurship based on certain criteria we have tried to determine. The first of these criteria is that the corporation is required to meet a social requirement with the activity it performs. That is, creating social value must be a principle within the business management model and the business management mission of the corporation,

The second criterion, on the other hand, is that the corporation must have the capacity to see and discover potential opportunities to create social value. Most important of all, it must apply innovative methods and meet a social requirement. Another criterion, in which all these are combined, is that the corporation must organize the activities it performs proactively, take the responsibility of these activities, and these activities must be long termed and it must realize a social transformation within the society. Certainly, the degree or intensity of these criteria may change, however, in order for a profit making company in the private sector to be considered a social entrepreneur; it must bear each of these criteria.
The manner in which the social entrepreneurship construct is conceptualised and the context in which it is premised in this paper, have important implications for practitioners and scholars. Implications for practitioners are that companies must define their social missions and they must discover and implement opportunities that would serve their social missions. Companies have the opportunity to eliminate the difficulties and inadequacies they experience while trying to find and implement these opportunities through both corporate entrepreneurship and strategic alliances they will form with non-governmental organizations.

As long as companies use these methods, even if they are not fully considered social entrepreneurs, they will have the chance to discover new opportunities where they can be accepted as social entrepreneurs and use their resources with innovative methods in line with these opportunities.

Implications for scholars are that there is a great need for analyzing the concept of social entrepreneurship in the context of profit-based private corporations. Theoretical studies can empower the structure of the concept. It is thus fundamental to consider the concept in future studies addressing the challenges and opportunities of applying social entrepreneurship in the private sector. Identifying new opportunities and creating new strategies, services, organizational structures, and management processes are needed to make a fundamental changes in the traditional activities of corporations.

# REFERENCES


Austin, James E. and Reficco, Ezequiel, (2009), Corporate Social Entrepreneurship, Working Paper, No:09-101, Harvard Business School, http://www.hbs.edu/research/pdf/09-101.pdf.

Austin, James E. (2000), Strategic Collaboration Between Nonprofits and Businesses, *Nonprofit and Voluntary Sector Quarterly,* 29 (1), pp.69-97.

Borins, S. (2000), Loose Cannons and Rule Breakers, or Enterprising Leaders? Some Evidence about Innovative Public Managers. *Public Administration Review,* 60, pp.498–507.

Chell, E., Karatas-Ozkan, M. and Nicolopoulou, K. (2005), Towards a Greater Awareness and Understanding of Social Entrepreneurship: Developing an Educational Approach and a Research Agenda through a Policy-driven Perspective, Paper presented at the *British Academy of Management Conference,* University of Oxford, September, http://ncge.com/files/biblio615.pdf.

Cooperrider, D.I and Pasmore, W.A. (1991), Global Social Change: A New Agenda for Social Science?, *Human Relations,* 44, pp.1037-1055.

CSR-Driven Innovation Report, http://www.designforum.fi/files/dff/pdf-tiedostot/CSR-DI_Report_final.pdf

Dart, R. (2004), The Legitimacy of Social Enterprise, *Nonprofit Management and Leadership,* 14 (4), pp.411-424.

Dees, J.G. (1998), Enterprising Nonprofits. *Harvard Business Review,* 76, pp.55-67.

Dees, J.G., (1998), The Meaning of Social Entrepreneurship, http://faculty.fuqua.duke.edu/centers/case/files/dees-SE.pdf.

Dees, J.G. and Anderson, B.B., (2003), For-profit Social Ventures. *International Journal of Entrepreneurship Education* (special issue on social entrepreneurship), 2, pp.1–26.

Dorado, Silvia, (2006), Social Entrepreneurial Ventures: Different Values, So Different Process of Creation, No?, *Journal of Developmental Entrepreneurship,* 11(4), pp.319-334.

Emerson, J. And Twersky, F. (Eds). (1996), New Social Entrepreneurs: The Success, Challenge and Lessons of Non-Profit Enterprise Creation. San Francisco: Roberts Foundation, Homeless Economic Development Fund.

Kanter, R.M., (1999), From Spare Change to Real Change. The Social Sector as Beta Site for Business Innovation, *Harvard Business Review,* 77(3), pp.122-132.

Kotler, Philip, Nancy Lee, (2006), Kurumsal Sosyal Sorumluluk, Çev: Sibel Kaçamak, İstanbul: MediaCat.

Mair, Johanna and Noboa, Ernesto, (2003), Social Entrepreneurship: How Intentions to Create a Social Enterprise Get Formed, WP No: 523, Working Paper, University of Navara.

Mort, S.G., Weerawardena, J. and Carnegie, K., (2003), Social Entrepreneurship: Towards Conceptualization, *International Journal of Nonprofit and Voluntary Sector Marketing,* 8 (1), pp. 76–88.

Naumes, Margaret J., Kammermeyer, Jill A. and Naumes, William, (2002), Social Entrepreneurship – A Relevant Concept for Business Schools? http://www.helleniccomserve.com/naumes.doc.

Nicholls, A., (2005), Measuring Impact in Social Entrepreneurship: New Accountabilities to Stakeholders and Investors?, Working Paper, University of Oxford, http://www.built-environment.uwe.ac.uk/research/ESRCseminars/pdfs/alex_nicholls_seminar4.pdf.

Peredo, A.M. and McLean, M., (2006), Social Entrepreneurship: A Critical Review of The Concept, *Journal of World Business,* 41, pp.56-65.

Porter Michael E. and. Kramer, Mark R., (2002), The Competitiv Advantage of Corporate Philanthropy, *Harvard Business Review,* pp.5-16.
Prabhu, G. N., (1998), Social Entrepreneurial Management Leadership in Management. www.mcb.co.uk/services/conferenc/sept98/lim/ paper_a2.htm.
Reis, T., (1999), Unleashing the New Resources and Entrepreneurship for the Common Good: A Scan, Synthesis and Scenario for Action. Battle Creek, MI: W.K. Kellogg Foundation.
Roper, Juliet and Cheney, George, (2005), Leadership, Learning and Human Resource Management: The Meanings of Social Entrepreneurship Today, *Corporate Governance*, 5 (3), pp.95-104.
Sagawa, S., and Segal, E., (2000), Common Interest, Common Good: Creating Value through Business and Social Sector Partnerships, *California Management Review,* 42 (2), pp.105-122.

Seelos, Christian and Mair, Johanna, (2004), Social Entrepreneurship: The Contribution of Individual Entrepreneurs to Sustainable Development, WP No:553, Working paper, University of Navara.
Shaw, E., and Carter, S., (2007), Social Entrepreneurship: Theoretical Antecedents and Empirical Analysis of Entrepreneurial Processes and Outcomes, *Journal of Small Business and Enterprise Development,* 14 (3), pp.418-434.

Smith, C. ,(1994), The New Corporate Philanthropy, *Harvard Business Review,* 72 (3), pp.105–116.

Thompson, J., (2002), The World of The Social Entrepreneur, *International Journal of Public Sector Management,* 15 (5), pp.412–431.
Thompson, J. L., Alvy, G. and Lees, A., (2000), Social Entrepreneurship: A New Look at The People and The Potential. *Management Decision,* 38, pp.328–338.
Tracey, Paul, Phillips Nelson and Haugh, Helen, (2005), Beyond Philanthropy: Community Enterprise as a Basis for Corporate Citizenship, *Jounal of Business Ethics*, 58(4), pp.327-344.
Wallace, S. L., (1999), Social Entrepreneurship: The Role of Social Purpose Enterprises in Facilitating Community Economic Development. *Journal of Developmental Entrepreneurship,* 4, pp.153–174.
Walter W. Wymer and Sridhar Samu,(2003), Non-Profit and Business Sector Collaboration, (Ed. Walter W. Wymer and Sridhar Samu), Haworth Press.
Weerawardena J. and Mort G. S., (2005), Investigating Social Entrepreneurship: A Multidimensional Model, *Journal of World Business,* 41, pp.21-35.
Wymer, Walter and Samu, Sridhar, (2003), Dimensions of Business and Nonprofit Collaborative Relationships, *Journal of NonProfit and Public Sector Marketing,* 11(1), pp.3-20.

Zahra. S.A, Gedajlovic E., Neubaum. D. and Shulman. J., (2008), Typology of Social Entrepreneurs: Motives, Search , Processes and Ethical Challenges. *Journal of Business Venturing,*18, pp.41-60.

# STRATEGIES FOR DEVELOPING THE SMES BUSINESS AND ENTREPRENEUR OPPORTUNITIES IN PAKISTAN

**F.M.Shaikh**
**SZABAC-Dokri-Larkana-Sindh, Pakistan**

**M.Saleem Rahpoto**
**SALU-Khairpur**

## ABSTRACT

*SMEs play an important role in the business as well economy of the country. Research was conducted from 100 SMEs units by using structured questionnaire as tool for the measurement. The data were analysis by using SPSS-16.5 software. It was revealed that different stages of SMEs business required the strategic planning and it was observed that SMEs most of the units are sick units in Pakistan because of lack of Planning strategies. The strategies however continuous strong growth is not necessarily one of the aims of an enterprise, then success has been measured in other ways.*
***Key words***: *Strategies, SME, Business, Developing*

## INTRODUCTION

Although strategy is a word more commonly associated with large originations, strategic decisions have been found to be just a significant to the success of small enterprise. This unit describes some of the main considerations in formulating small business strategies, taking into account the diversity of motives of the owner-manager. In the large Business, growth of sales & profits is a common strategic goal, but this is not always the case in small Business. Why not? What other strategic Objectives might a small business have? The size distribution of firms in the economy Unfortunately this narrow view of success consigns most small business into the category of unsuccessful. The vast majority of business does not grow beyond their classifications as a small firm only few grow to become medium size, and even fewer grow into the new large companies of the future. Large firms in the UK economy account for a very small percentage of the total No. of enterprises. As we saw earlier, (See Unit 1, Figure 1.2), 99 percent of UK Business fall into the E.C "Small" category of less the 50 employee and nearly 90 percent are "Micro" Enterprise of fewer then 10 employees. If the size distribution of firms is visualized as a pyramid, the base is extremely broad & the apex very narrow. If successes mean climbing from the bottom to the top, then it is rear in deeded.

## DATA COLLECTION METHODOLOGY

Research was conducted from 100 SMEs units by using structured questionnaire as tool for the measurement. The data were analysis by using SPSS-16.5 software.

### 1.2 MODEL OF GROWTH STAGES

This view of small business success or failure has been refined into various models of the growth stages of a small business. The number of stages various but a composite model is illustrated in figure 10.1.

## Phase 1: Concept / Test stage

The new business ideas is conceived, and planned. Full scale operations may (or may not) be preceded by detailed planning and testing in the market place. In some cases the business is run as a part time operation, before the owner places complete dependence on it. The small business begins operation and is developed to viability, or it is aborted at an early stage. This stage is typified as the individual owner-manager launching a new enterprise largely through his own efforts. Some analyses indicate curial periods when a small business will survive or fail. One such period is illustrated as the first 18-24 months, or it will not develop satisfactorily and suffer an early death. VAT statistics confirm this high level of early failures with only 68 percent of registrations surviving the first 2 years (see Unit 3, Figure 3.4)

## Phases 3: Growth / Decline Stage

The second curial phase is sometimes shown as occurring between the second and third years of operation. The growth that can occur at this time places organizational strains on the enterprise. The one-person entrepreneurial management style is seen as inadequate to fully sustain growth. A division of managerial tasks, the recruitment of non-owner-managers and the development of functionally organized team are seen as the prerequisites to take the business through this phase, without which it will struggle and often fail.

## Phase 4: Maturity

A further stage looks at the business maturing, and going through a period of stability, when growth flattens. The small firm loses its simple structure of centralized decision making, and become more sophisticated in its controls systems and more bureaucratic in its procedures. In other words it takes on some of the characteristics of a larger organization.

## Phase 5: Re-growth / Decline

The indification of a further phase, sometimes referred to as the s-curve hypothesis, suggests that once a small business has established it self in the market place, with a demonstrable competitive advantage, profit or external investment will follow the further exploit this early success. This will trigger a second period of a high growth. Without this second surge of growth, the lack of impetus in maturity phase can turn into stagnation and decline, as competition intensifies.

Whilst these models of the various growth stages of successful small enterprises contain aspects which are indeed descriptive of how businesses develop, they over look the statistical evidence, that most small business do not develop into larger organizations in this way it is true that many do fail; many more simply establish themselves and scurvies as small business, without becoming larger companies in either size or organizational structure.

## Developing SMEs growth Strategies

The general purpose of the management of any enterprise has been defined as the achievement of the organization objectives and a continuous improvement in its performance successful management is thus directly linked to the organization. If the objective of the business include high rate of growth, this clearly yardstick against which success of the management can be judge. If however continuous strong growth is not necessarily one of the aims of an enterprise, then success has been measured in other ways.

As many small business are the physiological extension of owner-manager, their personal motives and objectives will be crucial in assessing success or failure. Researches cast considerable doubt on weather growth is the common goal driving the small business owner forward. A survey of owner-manager business concluded that for owner-manager and staying independent. An other study reported that more then 30 per cent owners wanted their small firm stay at their present size. This echoes earlier work done at the time of the Bolton report which suggested that any owners paid lip services to the ideal of growth might threaten?.

Clearly the motives of owner-managers for entering into the world of small business will vary, giving rise to different objectives for their business. Attempts have been made to classify entrepreneurs in terms of their personal values, in order to distinguish between some of the more obvious types, and their possible objectives (see also Unit 2, The Entrepreneur and the Owner-Manager). Figure

The only common motive that can be attributed to owner managers with such differing backgrounds and desires is the survival of the business itself, for a sufficiently long period to deliver the objectives sought.

## Critical factors in the failure of young business

Young firms face problem in their formatives years which threaten survival.

**External influences**. Earlier in this book (unit 3, 1, A matter of life and death ) we reviewed the external influences outside of their control. Macro-economic conditions such as interest rates and overall levels of consumer demand, and micro environmental factors in the local catchments areas or industry sectors such as the intensity of competition, are important influences on weather a new venture sinks or swims.

**Internal factors**. The personal attributes, skills and competencies of the individual owner-manager are crucial to how well the business faces up to the investable crises that arise. Which particular important as some seem more critical to survival than others.
One study analyzed events which particularly threatened the survival of small ventures.

## Small business strategy

With a low probability growth, and a high risk of failure, can a small business, adopt strategies to improve in chance of success? Much advice is published on how to succeed as a small business owner. There is obviously much to be gained from listening to the practical advice of those who have experience of small enterprises. But can this be formulated into a prescriptive strategy to guide the small business owner?

These motives very from the craftsman seeking an alternative lifestyle to the opportunistic entrepreneur driven by materialistic gain; and

The objectives of small enterprises will also very therefore. High or continuous growth cannot be assumed as an objective. The only objective common to the whole small business sector seems to be that of survival, as the risk of failure is high.

## Strategies beyond survival

Beyond survival, strategies will depend on the objectives of the enterprise. However the quality of management and marketing and the quantity of money remain as key influences on the ability of the small firm to meet its objectives, whatever these happen to be. New strategies will need to build on, rather than detract from, these primary influences. The motives of the owner manager9s) are therefore a fourth influences to be added to the existing three. Unlike large companies where objectives arise from the influences of a variety of stake-holders, small enterprise strategy's driven by amore easily identifiable sources, often one person. This additional force in any development of strategy beyond survival is shown in figure 10.4 – the 4Ms"

Figure 10.4 key influences in small firm strategies beyond survival –the '4 Ms'
Again the influences overlap to represent the impact they can have on each other. For example.
Motives can point to one strategy which is thwarted by money or marketing considerations. An owner may be motivated to run a business which is completely environmentally friendly, only to find that money does not permit this policy to be fully implemented. A restaurant owner may have personal motives to provide only vegetarian food, but finds that the market place does not support this strategy. .Management consideration may indicate a strategy which is thwarted by the motives of the owner. An appropriate management structure for a growing business may never be implemented by an owner motivated by a strong desire for personal control. Marketing strategies may run counter to motives. An owner's desire to run what they perceived as a completely ethical business may prohibit certain sales approaches. Despites evidence of strong local demand and competitive advantage a trader may refuse to open on Sunday for personal reasons. Money influences may be diminished by personal motives. A desire to retain certain friendship may prevent rigorous pursuit of debtors. An owner with motives to promote their standing in the community may turn down the cheapest deal in favors of the local supplier.

## Activity For Growth

If small firm had the objective of high growth, how would its strategies be different from business with less ambitious growth plans?

## Strategies for growth

Small business can be divided into three broad categories for strategic analysis.

. Those likely to cease trading in the near future
. These likely to survive, but which will stay very small
. Those which will not only survive but will also grow rapidly.

As we have seen, the vast majority of small business falls into the first two categories. Only a tiny minority turn into the high growth enterprises which move quickly towards medium size status an beyond.

However their significance to the economy is much greater than their numbers imply. High growth firms are those that provide most employment prospects over 30 per cent of the new jobs created by small business are provided by the fasts growing 4 percent of firms. This section looks at some of the influences on their grown.

## The entrepreneur, the firm and strategy

In a review of the evidence on small business growth, Storey developed a framework of the characteristics of high growth small firm improving 3 components.

. The starting resources of the entrepreneur
. The firm
. Strategy

.External equity. Growing business is more likely to have obtained external funds from outside individuals or organizations. Market positioning High growth firm tend to occupy deliberately chosen market niches where they can exploit innovations and any technological sophistications they might have Innovation. New product or service introduction are key to small firm growth. Growth is restricted if non owning managers are not brought in. The section motivation and retention of a management team is important to increase the capabilities of the business.

## 4.2 Stages of growth

Are different strategies and skills required a different stages of a firm life?

Setting up a new business is not the same managerial task as running an existing fast growing one. The problems and issues seem to crop up in the same strategic areas, however. For example Drucker puts forward four requirements for the successful development of a new venture:

1. Focus on the market
2. Financial foresight, especially planning cash needs in advance of growth.
3. Building a top management team before it is required.
4. Careful definitions of the founder's roles in the enterprise.

## Successful small businesses strategies.

In this and other units the various influences on the like hood of, first the survival of a new venture and secondly, its growth into larger enterprises has been discussed. These have been divided into external and individual influences and into factors that particularly affect high growth firms. As growth is one of the key factors in survival, many of the influences on survival are similar to those that are important for high growth firms. A composite model of these influences is summarized in critical factors in small business strategies.

Unit 3 (section 5, 'Critical survival factors') summarized the external factors listed above unit 2 (section 6 'Towards successful entrepreneurship') analyzed the building block of successful entrepreneurship which make up the individual factors. This unit has added the important ingredient of motives. Together these factors influence the like hood of success or failure. The overlapping circle indicate the inter dependence of these force. For example the sector in which the firm is set up just as the decision on which sector to start a new venture in is influenced by personal factors and previous experience.

Few entrepreneurs develop a business in which all these factors are favorable disposed. If a complete set of favorable influence is not attainable, which are the most significant ones to get right? Research into successful small firm provides some guidance evidence from several studies suggests that the success of a small firm depend more upon the policies it adopted than the buoyancy of the market in which it operates. External influences are less important; than individual factors, particularly the management competencies and the personal attributes to cope with the small business environment. Some individual's successes an entrepreneur when the odds seems stacked against them, whilst other fail when the conditions for success are relatively good.

# CONCLUSIONS

Strategy may seem a work more applicable to larger organization then small However small business are similarly influenced by their strategic choices. The common perception might be that the typical small business is more often than not at the emergent end of the spectrum, whilst larger organizations are more deliberate in their strategies process. There is little hard evidence to support this view. Some commentators view entrepreneurial strategy as more toward the intended than the emergent end of the spectrum The focused control of small enterprise certainly make the process of formulating strategy easier than in large organization. The sheer size and complexity of some enterprises means that changing existing pattern to a deliberate new strategy is a difficult task. In a small business, the owner manger can embark on a new strategy with minimal consultation and communication.

# REFERENCES


1. Curran J. The small firm: a neglected area of management in cowling A et, al, Behavioral sciences for Mangers Amole, 1988.
2. See for example Scott, M and Bruce, R .Five stages of Growth in small business long range planning Vol 20 No.3, 1987 This describes the stages as: inception, survival, growth, expansion, maturity they also suggest that crises points fall before the next stages of development
3. See, part I unit 3, the small business environment sub section 3.1 small business closure rates which reviewed some statistics on small business longevity.
4. According to charter initiative (MCI) the key purpose of management is to achieve the organization objectives and continuously monitor its objectives Occupational standard MVCI The National Forum for management Education and Development 1991
5. A Survey of owner managed business Department of Employee, September 1990
6. The quarterly survey of small business in Britain Small Business Research Trust Open university (2nd Q 1989)
7. See especially Golby C W and Johns G Attitudes and Motivations committee of Inquiry on small firm Research Report No. 7 HMSO 1971
8. Identities of artisan, classical entrepreneur and manager are from Stan worth J and Curran J Rutledge 1991
9. Department of trade and Industry (DTI) small Firm in Britain 1996
10. Watkins, D Management Development and the Owner manager inWe3bb Quince and Watkins (eds) small business research Gower 1982
11. Berryman J Small Business Failure and Bankruptcy A survey of the literature international small Business Review 1 1983

# KNOWLEDGE TRANSFER (KT) PRACTICES IN SMALL AND MEDIUM ENTERPRISES (SMEs) of TURKISH TEXTILE AND APPAREL INDUSTRY

**Dababrata Narayan Chowdhury & Lynne Butel**
**University of Plymouth, UK**

**Hakkı Eraslan**
**International Competitiveness Research Institute (URAK), Turkey**

**Ismail Bakan**
**Kahramanmaraş Sütçü İmam University, Turkey**

## ABSTRACT

*This paper examines how knowledge is developed in supplier or buyer relationships in Turkish SMEs. The knowledge transfer activities in Turkish textile and apparel industry have been explored in this study. The knowledge transfer is undisputedly important subjects as knowledge provides competitive advantage to firms. Only few percentages of the Turkish textile and apparel industry are engaged in knowledge transfer activity although it is recorded as the largest industry in Turkish economy. Turkish textile and apparel industry is mostly run by family and most of them are either unaware or reluctant to involve in the knowledge transfer activities. This study examines the knowledge transfer practices in Turkish textile and apparel industry's SMEs through qualitative research and quantitative analysis by undertaking extensive literature reviews and present situation in Turkey.*

***Keywords:*** *Knowledge Transfer (KT), Turkish Textile and Apparel Industry, SMEs.*

## INTRODUCTION

Textile and apparel industry in Turkey has played a vital role in the industrialization process and market orientation of the economy in the last three decades. For many developing countries, the manufacturing sector serves as the main powerhouse in fuelling growth for the economy through the generation of export earnings and employment. The same as, in the early years of liberalization, the Turkish textile and apparel industry posted strong consistent growth in terms of exports. With the drive towards liberalization since the early 1980's, the textile and apparel industry gradually increased and eventually became one of the dominant industry groups in Turkey. During the period between 1980 and 2000, the textile and apparel industry alone recorded an average annual output growth of 20.5 percent and eventually became the country's largest manufacturing export industry in value terms (TGSD, 2008; IGEME, 2008; Eraslan, 2008). However, with the inclusion of China to the global textile and apparel market, the volume of textile and apparel exports of Turkey have started to decline since 2000s (ITKIB, 2008).

Textile and apparel industry has always had a forefront position in the economy of Turkey. Such activities at the industrial level date back to the early Ottoman period. Since those times, the highest levels of employment, production and profits in the economy of the country were obtained in textiles and related fields (Akalin, 2001; Ercan, 2002). Today, the textile and apparel sector employs 2 million people (*the 2nd largest employer after agriculture sector*), generates about 1/5$^{th}$ of the total export earnings and contributes 11% to the GDP thereby making it the largest industrial sector of the country (*14% of total manufacturing industry production*). The sector aspires to grow its revenue and export value (Eraslan, 2008; ITKIB, 2008).
This paper focuses on the process of knowledge transfer and its determinant factors that clarify its effectiveness for Turkish textile and apparel industry. In summary, the research in this paper is based on the understanding that knowledge transfer in a Turkish textile and apparel industry is critical to an organization's success, and that there is a need for more empirical investigation of knowledge transfer. In this research, an

attempt is made to determine the growing importance of knowledge transfer through determinant factors to the development of textile and apparel industry in Turkey.

## Understanding Knowledge Transfer (KT)

Transfer of knowledge from one set of individuals to another has been a key area of interest for knowledge management and knowledge transfer researchers. The terms *knowledge transfer* (Garvin, 1993; Gupta & Govindarajan, 2000a, 2000b), *knowledge dissemination* (Demarest, 1997; McAdams & McCreedy, 1999), *knowledge flows* (Gupta & Govindarajan, 2000b), and *knowledge distribution* (Huber, 1991) appear to be used interchangeably in the literature to describe the process of knowledge transfer. The literature identifies that knowledge transfer is a dynamic process between the individual or group and the organization's knowledge stocks. Knowledge moves simultaneously forwards and backwards between individuals, groups and the organization to become embedded in the organization's routines, behaviors and strategic orientations (Argyris & Schon, 1974; Argyris & Schon, 1978; Grant, 1996; Levitt & March 1988; March & Olsen 1975).
Transfer of knowledge includes two actions; one is transmission which means sending knowledge to potential receiver, and another is absorption meaning that knowledge must be incorporated either by a person or a group. As such, Davenport and Prusak have expressed this concept as *Transfer = Transmission+ Absorption* (Davenport & Prusak, 1998). The availability of knowledge is not sufficient; it should also ensure the usability of available knowledge. *Knowledge that isn't absorbed hasn't really been transferred (*Ibid*)*. Davenport and Prusak further argues that transmission and absorption has no meaning if new knowledge does not lead to some change in behavior. Bajracharya and Masdeu (2006) argue that considering this notion, it appears that transferring knowledge is rather very smooth process. Therefore, while knowledge transfer between firms includes the flow of knowledge between SMEs and the ability to understand and to utilize this knowledge, it also includes the reality that the evidence of knowledge transfer may not always be easy to observe because tacit knowledge is not as tangible; therefore when considering knowledge transfer we need to consider the character of knowledge.

## The Process of Knowledge Creation and Transfer

According to Argote and Ingram (2000) knowledge transfer in organizations is the process where one unit, e.g. group, department, or division learns by the experience of another. They recognized that knowledge can be transferred in two ways, either by moving a knowledge pool, people or technology, from one unit to another, or by modifying a knowledge pool. People and technology can thus be moved between units and modification can be achieved through communication and training. Tacit knowledge can be transferred to other tasks and contexts by moving people whereas transferring knowledge by embedding it in technology are only effective if accompanied by a few individuals because the individuals have the tacit knowledge and understanding behind the technology. The models based on Nonaka and Takeuchi's (1995) conventional theory of knowledge creation and the concept of intellectual capital (Stewart, 1997; 2001) provide an insight on the role of knowledge transfer in knowledge creation and explained next.

Nonaka and Takeuchi (1995) defined four independent modes for knowledge creation; (1) *socialization*, from tacit knowledge to tacit knowledge, (2) *externalization*, from tacit knowledge to explicit knowledge, (3) *combination*, from explicit knowledge to explicit knowledge, and (4) *internalization*, from explicit knowledge to tacit knowledge. Most knowledge is nevertheless created with the combination of the different modes. According to Nonaka and Takeuchi (1995) organizational knowledge is formed where knowledge is initially created by the individuals in the organization. Tacit knowledge becomes explicit and then transferred from individuals to groups and in the end to the organization. This creates a positive knowledge spiral (Nonaka & Takeuchi, 1995) which can start from any of the four modes but usually begins with socialisation. Polanyi's (1967) contradicted the above view because tacit knowledge cannot by definition be made explicit and knowledge transfer in a spiral mode cannot be thus accomplished. Figure 1.1 shows the knowledge transfer in spiral mode as indicated by Nonaka and Takeuchi (1995). The four modes used in knowledge transfer are now explained next.

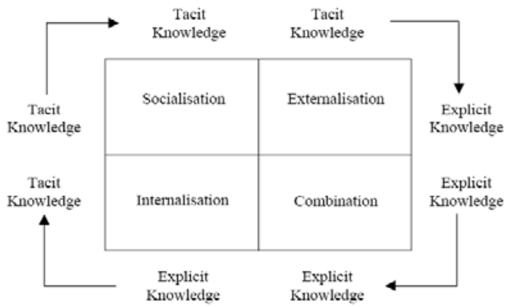



Figure 1.1: Four modes of Knowledge Creation and Transfer (Nonaka& Takeuchi, 1995)

# HYPOTHESES

The SMEs in Turkish textile and apparel industry, especially the larger ones and those with specialized knowledge and technology, do have clear growth strategies and generally have no problems complying with regulations, quality systems and staff development or in sharing their views with other network members or more widely (TGSD, 2008). Feedbacks obtained from face to face interviews indicated that most Turkish SMEs, even those that are active in several networks, do not have the inclination, knowledge or resource to comply. Lack of knowledge management, lack of interest and support from government and non-government organizations also hampers the progress of SMEs. More or less every Turkish SMEs covered in this interview indicated the growing need of IT for knowledge transfer within and between SMEs. Most of the SMEs lack knowledge sharing and importance of the trust on which the knowledge transfer can be effectively built. They also understood the importance of various IT components and expertise acting as a communication channel and their necessity for effective knowledge transfer. The next sections thus identify various factors under different themes on the basis of the available literature. To test the relevance of various themes for Turkish SMEs, two different hypotheses with eight sub-hypotheses are developed and will be further analyzed in coming section.

## $H_1$: Knowledge Sharing for KT

According to Nonaka and Takeuchi (1995) knowledge conception is considered like a growth process started by the individual and then moves across the organisation in a never-ending process. Davenport and Prusak (2000) suggested that knowledge transfer process involves two actions: transmission of knowledge to potential recipient, and absorption of the knowledge by that recipient that could eventually lead to changes in behaviour or the development of new knowledge.

The key aspects of knowledge transfer are thus transmission of some knowledge to the recipient leading to creation of new knowledge or changes in behavior. In the economic environment, firms must have the appropriate knowledge and use it efficiently. Because of geographical size and dispersion the transfer of existing organizational knowledge to other places knowing where it is actually needed becomes difficult (Davenport and Prusak, 1998). Boisot (1998) argues that successful knowledge transfer needs a *degree of resonance* between two or more agents. Knowledge transfer thus requires both the *transfer or sending* of knowledge from the source agent and the *internalization* or *learning* of that knowledge by the recipient agent. This transfer of knowledge depends on the type and complexity of the knowledge and is also affected by the attributes and behaviors of the human agents sharing that knowledge.

It is important to distinguish knowledge sharing at different levels: individual, group and organization. Huber (1991) indicated that knowledge sharing between individuals may not always be easily seen as some knowledge transfer. It can alter a person’s awareness but not their behavior. Knowledge sharing helps to obtain more complete knowledge and information to take better informed decisions (Gynawali, Stewert & Grant, 1997). Face to face interviews from persons at higher position in Turkish textile and apparel industry also indicated that 12 out of 18 considered the importance of sharing business ideas and information with buyers and 15 out of 18 with suppliers and that helps in knowledge transfer activities.

These determinants affecting the knowledge sharing will form the basis of hypothesis to study the impact of knowledge transfer in Turkish textile and apparel SMEs:

*$H_1$: Turkish SMEs share knowledge within their network*

$H_{1a}$: From buyer's ideas

$H_{1b}$: From supplier's ideas

*$H_2$: Implementation of IT technology*

**Huysman & DeWit (2002)** have noted that many knowledge management projects had their origin in the information technology (IT) world. Organizations believe that with the rise of advanced technology, opportunities to facilitate knowledge transfer and sharing with organizations are on the increase. **Frappaolo & Capshaw (1999)** noted that the key applications of KM projects are effectively connecting knowledge throughout the organization among different entities. The focus is on ensuring that each individual or group understands the knowledge available with sufficient depth as to be applied effectively in decision-making and improvement. IT had played a vital role in providing the infrastructure needed to support knowledge transfer and sharing within and between organisations. The media and channels of communication are one of the sources for the creation, storage and transfer of knowledge. **Swan *et al.* (1999)** conducted a study comparing two cases. One of them focused almost entirely on using IT (intranet) for knowledge transfer without considering any social factors. In the other, IT was used to provide a network to encourage sharing together with the recognition of the importance of face-to-face interaction for sharing knowledge. The emphasis was on encouraging active network among dispersed communities. According to this study it was observed that knowledge cannot be simply processed and it must be continuously re-created through dynamic, interactive social networking activity. Nonaka & Takeuchi **(1995) also** believed that IT enables data processing on a large scale, crossing the boundaries of time and space but should have social factor. Any technology-driven intervention aimed at supporting knowledge sharing therefore needs to be aligned with the social and organizational mechanisms of knowledge transfer.

Internet and E-mail system is a convenient tool to broadcast top management's messages to whole organization. Top management of an organization can send all at once a message in the text or video formats to every member of the organization using internet based broadcasting system (Nonaka, 1991). Yang (2003) also supported that these will help in reducing geographical barriers. Communication media such as *E-mail*, a *Video Conferencing System*, *Internal Electronics Bulletin Board* can thus be used for the quick transfer of new knowledge. *The Internet*, *the World Wide Web*, and other ongoing advancements in information technology (IT) are supporting the efforts to create, integrate, and transfer information and knowledge among SMEs networks (Stover, 2004). Face to face interview conducted also supported the use of IT resources and mostly indicated the application of Email (15/18), Internet (17/18), Company website (10/18), E-library (9/18), Internet electronic bulletin board (10/18) and Video conferencing (8/18) are useful for KT.

The below hypothesis in the context of Turkish SMEs study the effect of implementation of IT through many channels on knowledge transfer:

*$H_2$: Adoption and utilization of the IT applications in the Turkish SMEs is essential for their success:*

$H_{2a}$: by Company's website

$H_{2b}$: by E-mail

$H_{2c}$: by Video Conferencing

$H_{2d}$: by E-library

$H_{2e}$: by Internet

$H_{2f}$: by Internal Electronics Bulletin Board

# RESEARCH METHODOLOGY

The object of this section is to explain and discuss the methodology to propose the suitable types that match this study best. Firstly, semi-structured interviews were used to collect data for qualitative analysis. Secondly, a questionnaire was used to collect data for quantitative analysis. Both data was collected from Turkish textile and apparel industry at two different times to increase the reliability of the findings. This multi-method approach provided both a broader and complementary approach. The research intended to develop an understanding of knowledge transfer in a small number of SMEs, and then to explore this understanding in a large number of SMEs for quantitative analysis. The interview was first designed to gather qualitative information and then the questionnaire was used to collect data for quantitative analysis that built on the results from the analysis of the qualitative finding. The research then required further explanation of existing information moving into a positivistic paradigm. First, it was required to confirm the qualitative findings and increase the reliability of the results then investigate quantitative findings to improve the validity of the analysis and investigate knowledge transfer in better strength.

# Hypotheses Test and Results

This section tests the correlation and ANOVA test between two independent variables with knowledge transfer. The variables are ideas from buyers and suppliers and analysis is to test the relationship of these with KT.

Table 1.1: Correlation between Variables and Knowledge Transfer

| | | Knowledge Transfer | Share Ideas with Buyers | Share Ideas with Suppliers |
|---|---|---|---|---|
| Knowledge transfer | Pearson Correlation | 1,000 | | |
| | Sig. (2-tailed) | , | | |
| | N | 265 | | |
| Share ideas with buyers | Pearson Correlation | -,044 | 1,000 | |
| | Sig. (2-tailed) | ,475 | , | |
| | N | 264 | 264 | |
| Share ideas with suppliers | Pearson Correlation | -,026 | ,864 (**) | 1,000 |
| | Sig. (2-tailed) | ,670 | ,000 | , |
| | N | 265 | 264 | 265 |

** Correlation is significant at the 0.01 level (2-tailed).

The results in Table 1.1 indicates that there is a negative correlation between the sharing ideas with buyers [r= -0.044, N=264, p>0.05] and sharing ideas with suppliers [r= -0.026, N=265, p>0.05] with knowledge transfer, indicating that there is no significant relationship between sharing ideas with buyers and sharing ideas with suppliers with knowledge transfer.

Table 1.2: ANOVA Test for Hypothesis 1

| | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| Share Ideas with Buyers | Between Groups | 4,190E-02 | 3 | 1,397E-02 | ,932 | ,426 |
| | Within Groups | 3,897 | 260 | 1,499E-02 | <2.63 | |
| | Total | 3,939 | 263 | | | |
| Share Ideas with Suppliers | Between Groups | 5,761E-02 | 3 | 1,920E-02 | 1,723 | ,163 |
| | Within Groups | 2,908 | 261 | 1,114E-02 | <2.63 | |
| | Total | 2,966 | 264 | | | |

To understand this relationship in detail and see the effects of each level, one-way ANOVA test is conducted next. The data collected here studies the effect of multiple level of one factor with multiple observations at each level. Multiple t-tests are not the answer because there are a large number of groups. With this kind of layout a calculation of the mean of each level is required to observe the variation within each level. The comparison between the actual variations of the group averages with expected variation indicates the level effect present in the data. More detail of the level effects can be obtained by studying the deviation of the mean of each level from grand mean. The one-way ANOVA is useful to compare the effects of multiple levels with multiple observations at each level and utilized here to study the behavior of different variables on knowledge transfer. ANOVA puts all the data into one number (*F*) and provides one *P* for the null hypothesis. The ANOVA test compare to other comparison tests such as t- tests also has fewer experiment-wise error rates (***http://www.psychstat.missouristat.edu***), and considered appropriate here to test the hypothesis. Table 1.2 shows the ANOVA tests for hypothesis $H_1$ to consider the effect of two sub-hypotheses $H_{1a}$ and $H_{1b}$ on knowledge transfer. The relationship of each sub-hypothesis on knowledge transfer in Turkish SMEs is considered next.

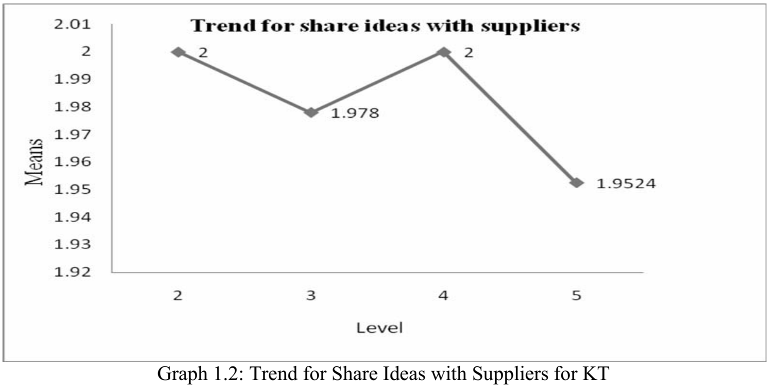
*$H_{1a}$: Turkish SMEs share knowledge within their network from buyer's ideas*

The Table 1.2 shows the value of F = 0.932 which is smaller than the critical value of 2.63 for the F-distribution at 3 and 260 degrees of freedom and 95% of confidence (*obtained using online calculator for critical value of F from http://**www.danielsoper.com***). The significant value p>0.05 indicates that effects are not significant. There is sufficient evidence to accept the null hypothesis and thus alternative hypothesis $H_{1a}$ is rejected.

*$H_{1b}$: Turkish SMEs share knowledge within their network from supplier's ideas*

The Table 1.2 shows the value of F = 1.723 which is smaller than the critical value of 2.63 for the F-distribution at 3 and 261 degrees of freedom and 95% of confidence. The significant value of $p>0.05$ with value of F indicates that the null hypothesis is accepted and thus alternative hypothesis $H_{1b}$ is rejected. This concludes that knowledge transfer is not directly affected with the sharing of knowledge from buyers and suppliers. The trend in means as shown in Graphs 1.1 and 1.2 also confirmed that there is weak form of relationship with knowledge transfer.


Graph 1.1: Trend for Share Ideas with Buyers for KT




Graph 1.2: Trend for Share Ideas with Suppliers for KT

Table 1.3: Summary of the Results of the Testing of Hypothesis 1

| | |
|---|---|
| *$H_{1a}$-From buyer's ideas* | *Not Supported* |
| *$H_{1b}$-From supplier's ideas* | *Not Supported* |

Finding for Hypothesis 1: The above two sub-hypotheses are not supported by the respondents and overall $H_1$ is thus rejected.

The following analysis will test the correlation between two variables from Turkish SMEs employees considering various factors supporting the hypotheses: *$H_2$: Adoption and utilization of the IT applications in the Turkish SMEs is essential for their success*. The correlation coefficients will be first conducted to test the supporting relation between these two variables for the same factor. For example in case of a Company's website, how useful this factor is for adoption and utilization of IT in the organization. This correlation coefficient will thus indicate the support of each factor in the adoption and utilization of IT technology.

The Table 1.4 shows the correlation coefficients and significance levels for each factor. There is a strong positive correlation between the two variables for Company's website [r = 0.815, N=260, p<0.01], indicating that Company's website is important. Similarly there is strong positive relationship for E-mail [r = 0.825, N=265, p<0.01], Internet [r = 0.405, N=265, p<0,01] and Internet Electronic Bulletin Board [r = 0.437, N=265, p<0.01]. Only two factors show weak relationship but both are positive with high statistical significant. The value for Video conferencing is [r = 0.132, N=265, p<0.05] whereas for E-library is [r = 0.242, N=265, p<0.01]. The comparatively low value is may be due to the unawareness of these two new technologies in Turkey for KT.

Table 1.4: Correlation Test for Hypothesis 2 ($H_2$)

**Correlations**

| | | T Most useful for Idea sharing-Company`s website | T Most useful for Idea sharing-Email | T Most useful for Idea sharing-Video conferencing | T Most useful for Idea sharing-E-Library | T Most useful for Idea sharing-Internat | T Most useful for Idea sharing-Internal Electronic Bulletin Board | how good IT applications used by employees-company`s website | how good IT applications used by employees-Email | how good IT applications used by employees-Video Conferencing | how good IT applications used by employees-E-library | how good IT applications used by employees-Internet | how good IT applications used by employees-Internal Electronic bulletin board |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| IT Most usefull for Idea sharing-Company`s website | Pearson Correlation | 1 | .815** | .113 | -.097 | .584** | .611** | .815** | .671** | -.447** | -.447** | .409** | .281** |
| | Sig. (2-tailed) | | .000 | .070 | .119 | .000 | .000 | .000 | .000 | .000 | .000 | .000 | .000 |
| | N | 260 | 260 | 260 | 260 | 260 | 260 | 260 | 260 | 260 | 260 | 260 | 260 |
| IT Most usefull for Idea sharing-Email | Pearson Correlation | .815** | 1 | .110 | -.094 | .738** | .714** | 1.000** | .825** | -.558** | -.558** | .500** | .340** |
| | Sig. (2-tailed) | .000 | | .073 | .127 | .000 | .000 | .000 | .000 | .000 | .000 | .000 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| IT Most usefull for Idea sharing-Video conferencing | Pearson Correlation | .113 | .110 | 1 | -.088 | .036 | .065 | .110 | .053 | .132* | .132* | -.045 | .076 |
| | Sig. (2-tailed) | .070 | .073 | | .154 | .565 | .290 | .073 | .392 | .031 | .031 | .462 | .215 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| IT Most usefull for Idea sharing-E-Library | Pearson Correlation | -.097 | -.094 | -.088 | 1 | .120 | -.229** | -.094 | -.010 | .242** | .242** | -.096 | -.140* |
| | Sig. (2-tailed) | .119 | .127 | .154 | | .052 | .000 | .127 | .871 | .000 | .000 | .120 | .022 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| IT Most usefull for Idea sharing- Internat | Pearson Correlation | .584** | .738** | .036 | .120 | 1 | .527** | .738** | .611** | -.436** | -.436** | .405** | .399** |
| | Sig. (2-tailed) | .000 | .000 | .565 | .052 | | .000 | .000 | .000 | .000 | .000 | .000 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| IT Most usefull for Idea sharing- Internal Electronic Bulletin Board | Pearson Correlation | .611** | .714** | .065 | -.229** | .527** | 1 | .714** | .654** | -.381** | -.381** | .421** | .437** |
| | Sig. (2-tailed) | .000 | .000 | .290 | .000 | .000 | | .000 | .000 | .000 | .000 | .000 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| how good IT applications used by employees-company`s website | Pearson Correlation | .815** | 1.000** | .110 | -.094 | .738** | .714** | 1 | .825** | -.558** | -.558** | .500** | .340** |
| | Sig. (2-tailed) | .000 | .000 | .073 | .127 | .000 | .000 | | .000 | .000 | .000 | .000 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| how good IT applications used by employees-Email | Pearson Correlation | .671** | .825** | .053 | -.010 | .611** | .654** | .825** | 1 | -.405** | -.405** | .474** | .292** |
| | Sig. (2-tailed) | .000 | .000 | .392 | .871 | .000 | .000 | .000 | | .000 | .000 | .000 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| how good IT applications used by employees-Video Conferencing | Pearson Correlation | -.447** | -.558** | .132* | .242** | -.436** | -.381** | -.558** | -.405** | 1 | 1.000** | -.182** | -.321** |
| | Sig. (2-tailed) | .000 | .000 | .031 | .000 | .000 | .000 | .000 | .000 | | .000 | .003 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| how good IT applications used by employees-E-library | Pearson Correlation | -.447** | -.558** | .132* | .242** | -.436** | -.381** | -.558** | -.405** | 1.000** | 1 | -.182** | -.321** |
| | Sig. (2-tailed) | .000 | .000 | .031 | .000 | .000 | .000 | .000 | .000 | .000 | | .003 | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| how good IT applications used by employees-Internet | Pearson Correlation | .409** | .500** | -.045 | -.096 | .405** | .421** | .500** | .474** | -.182** | -.182** | 1 | .257** |
| | Sig. (2-tailed) | .000 | .000 | .462 | .120 | .000 | .000 | .000 | .000 | .003 | .003 | | .000 |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |
| how good IT applications used by employees-Internal Electronic bulletin board | Pearson Correlation | .281** | .340** | .076 | -.140* | .399** | .437** | .340** | .292** | -.321** | -.321** | .257** | 1 |
| | Sig. (2-tailed) | .000 | .000 | .215 | .022 | .000 | .000 | .000 | .000 | .000 | .000 | .000 | |
| | N | 260 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 | 265 |

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The data collected suits for the Chi-square test and it is now performed to explore the relationship between two categorized variables to test the Null hypothesis.

Company's Website ($H_{2a}$**)**

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 715,828[a] | 12 | ,000 |
| Likelihood Ratio | 597,239 | 12 | ,000 |
| Linear-by-Linear Association | 172,174 | 1 | ,000 |
| N of Valid Cases | 260 | | |

a. 3 cells (15,0%) have expected count less than 5. The minimum expected count is 2,05.

The Pearson Chi-square value for Company's website as shown in above table is with 12 degree of freedom =715,828 and significance value $p < 0.05$. These results indicate that there is statistically significant relationship between the variables and thus Null hypothesis $H_{2a}$ is rejected. This implies that alternative hypothesis $H_{5a}$ is supported. However, the Chi-square test does not indicate the extent of relationship between two variables.

E-mail ($H_{2b}$)

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 658,974[a] | 9 | ,000 |
| Likelihood Ratio | 567,427 | 9 | ,000 |
| Linear-by-Linear Association | 179,816 | 1 | ,000 |
| N of Valid Cases | 265 | | |

a. 0 cells (,0%) have expected count less than 5. The minimum expected count is 6,66.

These results indicate there is statistically significant relationship between the variables for E-mail (*chi-square with 9 degree of freedom = 658,974, p<0.05*) and thus Null hypothesis $H_{05b}$ is rejected implying that alternative hypothesis $H_{2b}$ is supported.

Video conferencing ($H_{2c}$)

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 109,428[a] | 9 | ,000 |
| Likelihood Ratio | 59,330 | 9 | ,000 |
| Linear-by-Linear Association | 4,625 | 1 | ,032 |
| N of Valid Cases | 265 | | |

a. 8 cells (50,0%) have expected count less than 5. The minimum expected count is ,14.

These results indicate there is statistically significant relationship between the variables for Video conferencing (chi-square with 9 degree of freedom = 109,428, p<0.05) and thus Null hypothesis $H_{05c}$ is rejected implying that alternative hypothesis $H_{2c}$ is supported.

E-library ($H_{2d}$)

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 436,276[a] | 12 | ,000 |
| Likelihood Ratio | 280,571 | 12 | ,000 |
| Linear-by-Linear Association | 15,478 | 1 | ,000 |
| N of Valid Cases | 265 | | |

a. 12 cells (60,0%) have expected count less than 5. The minimum expected count is ,18.

These results also report that there is statistically significant relationship between the variables for E-library (chi-square with 12 degree of freedom = 436,276, p<0.05) and thus Null hypothesis $H_{2d}$ is rejected implying that alternative hypothesis $H_{2d}$ is supported.

Internet ($H_{2e}$)

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 64,196[a] | 9 | ,000 |
| Likelihood Ratio | 62,263 | 9 | ,000 |
| Linear-by-Linear Association | 43,198 | 1 | ,000 |
| N of Valid Cases | 265 | | |

a. 0 cells (,0%) have expected count less than 5. The minimum expected count is 5,13.

These results show that there is statistically significant relationship between the variables for internet (*chi-square with 9 degree of freedom = 64,196, p<0.05*) and thus Null hypothesis $H_{2e}$ is rejected implying that alternative hypothesis $H_{2e}$ is supported.

Internet Electronic Bulletin Board ($H_{2f}$)

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 291,536[a] | 9 | ,000 |
| Likelihood Ratio | 257,380 | 9 | ,000 |
| Linear-by-Linear Association | 50,512 | 1 | ,000 |
| N of Valid Cases | 265 | | |

a. 3 cells (18,8%) have expected count less than 5. The minimum expected count is 2,44.

These results indicate that there is a statistically significant relationship between the variables for Internet electronic bulletin board (*chi-square with 9 degree of freedom = 291,536, p<0.05*) and thus Null hypothesis $H_{2f}$ is rejected implying that alternative hypothesis $H_{2f}$ is supported.

Table 1.7: Summary of the Results of the Testing of Hypothesis 2

| | |
|---|---|
| *$H_{2a}$-Companys Website* | *Supported* |
| *$H_{2b}$-E-mail* | *Supported* |
| *$H_{2c}$ -Video Conferencing* | *Supported* |
| *$H_{2d}$-E-library* | *Supported* |
| *$H_{2e}$-Internet* | *Supported* |
| *$H_{2f}$- Internal Electronics Bulletin Board* | *Supported* |

Finding for Hypothesis 2

The above six sub-hypotheses are supported by the views indicated by the employees in the Turkish SMEs and overall $H_2$ is thus accepted.

Finally, the results show that hypothesis $H_1$ is not accepted because the respondents did not think that ideas obtained from buyers and suppliers can be used to enhance the knowledge transfer in SMEs. Finally various IT resources are considered in line with the available literature to find the effect of these for KT in Turkish SMEs. The analysis results show that some of the known IT technologies in Turkey such as E-mail, Internet, website etc. are also considered valuable and the related hypothesis $H_2$ is also accepted. This shows the general trend of considering various themes affecting the development of KT in Turkish textile and apparel industry.

## Limitations of the Study:

This study provides an insight into the Turkish textile and apparel industry and establishing the qualitative and quantitative approach to find out the important determinants for knowledge transfer activities and was conducted using standard procedures. A number of limitations, however, are noted for this study:

- Textile and apparel industry is one of the biggest manufacturing industries in Turkey and data collected for analysis were from only 265 respondents. The response might not thus truly representative of the whole Turkey and the findings may not be generalized at large.
- The study was conducted only in the four big cities (*Istanbul, Ankara, Bursa and Izmir*) but textile and apparel industry in Turkey is widespread in small towns and villages and may represent different views for KT.
- One of the limitations of this research is the complexity of the terms used for knowledge transfer in Turkish textile and apparel industries and was narrowed down sometimes for the purpose of the study.

Further Recommendations:

- A number of recommendations, which follow from this initial study, are made below for future research:
- This study can be extended to study the knowledge transfer activities in any SMEs discipline.
- A larger study might be conducted by adding the parameter to study the knowledge transfer mechanism in any big enterprises.
- This study can be used to make a comparison of knowledge transfer activities in SMEs either in the same country or several developing countries.

# CONCLUSION

Accepting knowledge transfer activities in a broader perspective is both beneficial and important because it provides a set of tools and a visualization that allows better understanding and certain interventions if needed. Elements including knowledge sharing and IT technology played a big role in this study in discovering the knowledge transfer practices in Turkish SMEs.

A vast majority of the Turkish textile and apparel industry is run as a family business and they mostly rely on old technology and also are reluctant to change. Owners or managers do not consider that KT is important for the success of their business and want to prevent outflow of knowledge from the company. This also puts barriers in acquiring knowledge from outside, and makes knowledge transfer activities even harder. This study proposed four themes necessary for the success of KT and illustrated the important practices used to achieve effective knowledge transfer in Turkish textile and apparel industry. Although many factors considered in literature reviews were found not important in the context of Turkish textile and apparel industry but are sufficient at present to influence the other textile and apparel industries to start the knowledge transfer activities in their organization. They require to shed their conservative approach and to adopt best practices from all over the world to survive in today's rapidly evolving global market with intense competition. Therefore, the textile and apparel industry in Turkey adapt to practices the knowledge transfer activities and this will both help and enforce them to improve continuously. The results point to knowledge transfer in a firm to be crucial for subsequent actions in the Turkish market. Another implication for mangers is that the customer is connected to other business therefore supplier has to understand what happens in the business exchange for knowledge sharing activities.

# REFERENCES


- Akalin, M. (2001), Insight into the Turkish Textile and Apparel Industry, *Electronic Journal of Textiles*, Vol 1, No 1, 25 (1), pp: 107- 133.
- Argote, L., and Ingram, P., (2000), Knowledge transfer: A Basis for Competitive Advantage in Firms, *Organisational Behavior and Human Decision Processes*, 82 (1), pp: 150- 169.
- Argyris, C., and Schon, D.A., (1974), *Theories of Action in Practice – Increasing Professional Effectiveness.* Jossey– Bass, San Francisco.

- Argyris, C., and Schon, D.A., (1978), *Organizational Learning: A Theory Action Perspective*. Addison-Wesley, Reading MA.
- Bajracharya, P., Masdeu, N.R., (2006), Tacit Knowledge Transfer, In Small Segment of Small Enterprises, International Master's Program in Strategy & Culture LIU– EKI/STR- D- 06/003- SE, Linköping University, Sweden.
- Boisot, M., (1998), *Knowledge Assets: Securing Competitive Advantage in the Information Economy*, Oxford University Press, New York.
- Davenport & T. Dickson (Eds.). *Mastering information management*. London: Prentice Hall.
- Davenport, T.H., and Prusak, L., (2000), *Working Knowledge. How Organizations Manage What They Know*. Harvard Business School Press, Boston.
- Davenport, T.H., and Prusak, L., (1998), *Working Knowledge: How Organizations Manage What They Know*, Harvard Business School Press, Boston, MA.
- Demarest M., (1997), Understanding Knowledge Management, *Long Range Planning*, 30 (3), pp: 374-384.
- Eraslan, İ.H., (2008), *The Effects of Competitive Strategies on Firm Performance: A Study in Turkish Textile and Apparel Industry Considering Mediating Role of Value Chain Activities*, Unpublished PhD Dissertation, Boğaziçi University.
- Ercan E., (2002), Changing World Trade Conditions Force the Turkish Textile and Apparel Industry to Create New Strategies, *Journal of Textile and Apparel, Technology and Management*, Vol 2, Issue IV, Fall.
- Export Promotion Center (İGEME) (2008), Annual Reports and Statistical Data, T.C. Başbakanlık İhracatı Geliştirme Etüd Merkezi (İGEME), retrieved from http://www.igeme.org.tr.
- Frappaolo, C., and Capshaw, S., (1999), Knowledge Management Software: Capturing the Essence of Know-how and Innovation, *The Information Management Journal,* July, pp: 44- 48.
- Garvin D.A., (1993), Building a Learning Organisation, *Harvard Business Review*, July/ August, pp: 78-91.
- Grant, R.M., (1996), Prospering in Dynamically Competitive Environments: Organizational Capability as knowledge integration, *Organisation Science*, 7 (4), pp: 175- 387.
- Gutpa A.K. & Govindarajan V., (2000a), Knowledge Flows Within Multinational Corporations, *Strategic Management Journal*, 21, pp: 473- 496.
- Gutpa A.K. & Govindarajan V., (2000b), Knowledge Management's Social Dimensions: Lessons from Nucor Steel, *Sloan Management Review*, Fall, pp: 71- 80.
- Gynawali, R., Stewert, H., and Grant, H., (1997), Creation and Utilization of Organizational Knowledge: An Empirical Study of the Role of Organizational Learning on Strategic Decision Making, *Academy of Management Proceedings*, pp: 16- 20.
- Howells J. R. L. (2002), Tacit knowledge, innovation and economic geography. Urban Studies, 39(5-6): 871-84.
- Huber, G., (1991), Organisational Learning: The Contributing Processes and the Literatures, *Organisation Science*, 2 (1), pp: 88- 115.
- Huysman, M., and DeWit, D., (2002), *Knowledge Sharing in Practice,* Kluwer Academics, Dordrecht.
- Koulopoulos T.M. & Frappaolo C. (2000), *Smart things to know about knowledge management*. Oxford: Capstone Publishing.
- Levitt, B., and March, J.G., (1988), Organisational learning, *Annual Review of Sociology*, 14, pp: 319-340.
- March, J.G., and Olsen, J.P., (1975), The Uncertainty of the Past: Organizational Learning under Ambiguity, *European Journal of Political Research*, 3, pp: 147- 171.
- McAdam, R.,and McCreedy, S., (1999), The Process of Knowledge Management within Organizations: A Critical Assessment of Theory and Practice, *Knowledge and Process Management*, 6 (2), pp: 101-113.
- Nonaka, I., (1991), The Knowledge Creating Company, *Harvard Business Review*, 69, pp: 96– 104.
- Nonaka, I., and Takeuchi, H., (1995), *The Knowledge Creating Company*, Oxford Press, Oxford.
- Polanyi, M. (1967), *The Tacit Dimension*. Anchor, Garden City, NY.
- Rumizen M.C. (2002), *The complete idiot's guide to knowledge management*. Indianapolis: Alpha Books.
- Stewart T.A. (2001), Intellectual Capital: Ten Years Later, How Far We've Come, *Fortune*, May 28, pp: 1- 3.
- Stewart, T., (1997), *Intellectual Capital: The New Wealth of Organizations*, Currency Doubleday, New York, NY.

- Stover, M., (2004), Making Tacit Knowledge Explicit, *Reference Services Review*, Vol 32, No 2, pp: 164- 73.
- Swan J., Newell S., Scarbrough, H., and Hislop, D., (1999), Knowledge Management and Innovation: Networks and Networking, *Journal of Knowledge Management,* 3 (4), pp: 262- 275.
- The General Secreteriat of Istanbul Textile and Apparel Exporter Associations (ITAES) (2006), *Annual Reports and Statistical Data*, İstanbul Tekstil ve Konfeksiyon İhracatçıları Birlikleri Genel Sekreterliği (ITKIB), Retrieved from **http://www.itkib.org.tr**
- Turkish Clothing Manufacturers Association (TCMA) (2008), Annual Reports and Statistical Data, Türkiye Giyim Sanayicileri Derneği (TGSD), Retrieved from http://www.tgsd.org.tr
- Yang, G., (2003), The Internet and Civil Society in China: A Preliminary Assessment, *Journal of Contemporary China*, Vol 12, No 36, pp: 453- 475.


**INTERNET LINKS**

- For SPSS http://www.psychstat.missouristat.edu
- http://www.kosgeb.gov.tr/Ekler/Dosyalar/Information/6/Sme.doc

# CLUSTER-BASED STRATEGIES for COMPETITIVE ADVANTAGE of SMALL AND MEDIUM ENTERPRISES (SMEs)

**İ. Hakkı Eraslan & Melih Bulu**
**International Competitiveness Research Institute (URAK), Turkey**

**İsmail Bakan**
**Kahramanmaraş Sütçü İmam University, Turkey**

**Dababrata Narayan Chowdhury**
**Plymouth University, UK**

## ABSTRACT

*Enhancing and sustaining competitive advantage of SMEs, which exert countless useful functions in socio-economic area, stand as one of the prominent and important agenda items of economic programs of EU, and developed and developing countries. In this respect, in framework of pre-determined programs and approaches, a great many of studies are made by both local and central decision-makers to develop qualities of SMEs on the way to achieve sustainable competitive advantage. Based on the cluster approach, this study aims to reveal the required strategic framework to improve competitiveness of SMEs, and aid policy-makers and executers in determining priorities in policies prepared. A comprehensive literature review together with fieldwork was done in order to accomplish this aim. Qualitative research techniques, such as expert opinion, in-depth interview, and group discussion, are conducted in fieldwork as data collection methods. The output of the collected data reveals that; clusters, the widespread approach throughout the world, affect the competitive advantage of SMEs.*

***Keywords:*** *Competitiveness, Cluster Approach, SMEs, Strategic Management, Cluster Policies.*

## INTRODUCTION

Although there is no universal definition of SMEs; however, number of personnel employed, annual sales volume, capital size, and assets size are widely used as factors used to define SMEs. Nevertheless, regardless of the definition SMEs, displaying positive and synergic effects in national, regional, and sectoral development phases, in industrialization practices, even in liberalization process; play an important and active role both in social and economic life. SME type enterprises, especially in the globalized world order, make major contributions to the protection of social fabric as a balance factor of income gap, and a social security factor in liberal economies and democratic societies. These enterprises employ young people, support innovation and entrepreneurship, act as complementary of large companies, and provide a wide product range requiring less investment thanks to their flexibility. Moreover, SMEs are affected less by economic crisis and fluctuation and prevent monopolization (Oktav et al., 1990; Ekin, 1993; Özok, 1993; Şenyurt, 1995; Sarıaslan, 1996; Palas, 1996; Balçık, 1997; Erkan, 1997; Alpugan, 1998; Koyuncu, 1998; Çelik, 1999; Pınarcıoğlu, 2000; Yücel, 2001; Akgemci, 2001; Oktay and Güney, 2002; Wolf and Musaoğlu, 2002; Erdil, Imamoğlu and Keskin, 2003; Özkan et al., 2003; Ören, 2003; Baykal and Güneş, 2004; Alasrag, 2006; KOSGEB, 2008). SMEs are widely accepted as major building structures by almost all sector players. Even, as is the case in all EU member countries, 99% of manufacturing firms in Turkey are SMEs (DPT, 2004; TUİK, 2008). SMEs also serve as the building structures in the cluster formation process as the effective links in value chains of manufacturing industry and service sector. Top executives and/or firm owners in Turkey, who are responsible for decision making in SMEs, can be regarded as successful at gaining competitive advantage through employing internal resources of the enterprise. It is, however, observed that external resources of the enterprise are kept at background in assessing opportunities by those decision makers. Analysis conducted point out that firms functioning in the same industry possess a weak culture of collaboration and suffer from trust problem. Regarding this issue, the cluster approach has been accepted and used lately to form the collaboration media required by firms to assess the opportunities of the sector, and this approach is anticipated as a new and important means to increase the competitive advantage of Turkish SMEs, as well.

Today, clusters stand out as a formal, industrial and a guiding approach for development plans to increase international competitive advantage of countries, sectors, and accordingly SMEs. Many cluster-based projects and analysis have been done and developed by various institutions and enterprises throughout the world, and cluster approach has been adopted as a tool for regional and local development. USA, Canada, Mexico, Argentina, Brazil, Chile, Colombia, Costa Rica, Guatemala, Nicaragua, Venezuela, Sweden, Norway, Australia, Malaysia, New Zealand, Singapore, Morocco, South Africa, Senegal, Kazakhstan, and Russia are the leading countries that have begun to use the cluster approach. Likewise, some of the leading institutions that have used the cluster approach in their development plans are OECD, UNIDO, World Bank, UNCTAD, European Commission (Enright and Ffowcs-Williams, 2001; Landabaso, 2001). Public sector in Turkey actualizes wealth transfer to cities through both public investments, and loans and incentives granted to private sector with the aim of overcoming the inter-regional differences in terms of development, strengthening the regional competitiveness, and providing a country scale sustainable development. Within the framework of the policy described as the *Principle of Equity*, the said wealth transfer is generally performed towards less-developed regions; therefore, a fair mechanism is expected to be formed in strengthening regional competitiveness. However, practices in other places of the world indicate that, state intervention to market through wealth transfer, on the contrary to the belief of higher welfare, mostly fails to decrease regional inequities; worse still, hinders growth throughout the country (Aydemir, 2002; Kumral, 2006: 279). Hence, regional policies in Turkey are in a state of preference between efficiency notions, which result in equity and competitiveness. This preference can be either countrywide economic growth and productivity boost or establishing equity through overcoming inter-regional differences (Aydemir, 2002: 145). *Cluster is an approach*, which brings contemporary concepts together and builds up competitive structures at regional level and within both small and large firms. In this context, clusters serve as the connecting point of local administration, local authority, private establishments, research institutions, non-governmental organizations (NGOs), and other related players of the community. Thus, plans and applications are actualized through participation of local players, contrary to centralism. This process involves selection of highly competitive sector/s, and completion of absent players, while aiming to realize the required level of communication in between. The main purpose here is to increase the competitiveness of the sector and make it sustainable. Participants of the cluster decrease the transaction cost and trigger productivity and innovation through synergy that come up with the communication channels, buyer-supplier relationship, cooperative marketing, R&D, training, sectoral NGO's that are established as a consequence of cluster approach.

## Concept of Competitive Advantage and SMEs

Concepts of *Competition* and *Competitive Advantage* are two terms that are used frequently in different meanings without referring to a clear definition. (Alderson, 1965; Hall, 1980; Henderson, 1983; Porter, 1985; Day and Wensley, 1988; Prahalad and Hamel, 1990; Dinçer, 1996; Eren, 2002; Ülgen and Mirze, 2004). A common and simple definition of the *Competition* is *The Struggle of Life*, whereas it can be also defined as the effort of two or more people/parts trying to outrun each other. However, objectives of those competing parts may differ a lot. For instance, people or teams struggle for a medal; whereas firms struggle to increase profit, and countries to improve the common welfare or to gain political power.

*Competitiveness* is defined as the ability to compete. From the economic perspective, competitiveness involves many variables and depends on quality, speed, technical advantage, and service or product differentiation (Çınar, 2005: 3). The term can be classified into three groups; namely, *macro*, *meso* and *micro* (Moon and Peery, 1995; Porter, 1990a; Depperu and Cerrato, 2005). Among these, the term *macro* stands for the national level, *meso* for regional or sectoral level and *micro* represents firm (large or SME type firms) level competition. Macro level competitiveness is producing goods and services that find acceptance in international markets while conserving high and sustainable income level. In other words, the macro level competitiveness is the ability of firms, industries, regions, nations, or supranational regions to produce relatively high income and employment while competing in international markets (Aydemir, 2002: 18). Nevertheless; macro, meso and micro level competitiveness are relative concepts. Macro level competitiveness can sometimes be regarded as micro and/or meso level competitiveness, as well. It is noteworthy that contemporary world trade is shaped by the competitive advantage which macro, meso, and micro level players' possess through producing goods and services. In other words, the competitive advantage of a country is capable of changing the economic equilibrium of the world.

There have been many authors and researchers defining the qualification and content of competitive advantage in various forms through the history. In this context, *Resource-Based View* (Barney, 1991; Prahalad and Hamel, 1990; Teece et al., 1997), *Innovation Approach* (Shumpeter, 1934), and *Knowledge-based Approach* (Senge, 1990; Nonaka, 1991) stand as pioneer studies. However, Porter's Model for Industry Analysis (1980, 1985) has come up as a more effective approach in literature of competitive strategies. Porter (1985: 996), one of the leading thinkers of position approach, asserts that gaining competitive advantage depends on adopting competitive strategies; accordingly contends that one of two strategies (1) differentiation or (2) low-cost should be chosen. Cost leadership requires establishment of facilities functioning at an efficient scale, notable cost reduction by means of experience, rigid overhead cost control, get rid of small customer accounts, R&D, service, sales power; namely cost reduction in many areas. On the other hand, differentiation is defined as the introduction of something unique in that industry through differentiating the product or service the firm offers. Differentiation can be achieved through many different ways (*design or brand name, technology, customer service, sales network, etc.*). The ideal strategy for the firm is to differentiate in various dimensions and functions. It is important to bear in mind that, some features countries may possess or not, affects the development and international success of some industries. Input cost, and input quality, selectivity of local buyers and structure of demand, structure and intensity of local competition, and local features of supplying and supporting industries may affect the competitive advantage of national firms or sectors positively or negatively. On the other hand, human resources, organizational structure, and technological capability also affect the competitive advantage of nations, sectors, or firms in international markets (Kumar and Chadee, 2002: 21; Bulu, Eraslan and Kaya, 2006; Bulu, Eraslan and Karataş, 2007). For SMEs, competitiveness is an indispensable factor both to survive economically and to make profit. On the other hand, the rapid developments in social, technological, and economical areas, easy access to information, etc. have strengthened the globalization phenomenon, which has fastened and liberalized the flow of goods and services throughout the world. The case has affected the competitiveness power of SMEs operating in Turkey, and called forth many problems on financing, marketing, management production, etc. (Küçükçolak, 1998; Göker, 1998; Erkumay, 2000; Atik and Sezer, 2001; Oktay and Güney, 2002; Coşkun, 2004). Enhancing and sustaining competitive advantage of SMEs have been important agenda items for both entrepreneurs and policy-makers. Decision makers, whose purpose is to identify macro, meso and micro level policies, and strategies for SMEs to gain sustainable competitive advantage, also plan, organize, and direct these enterprises on how to position themselves in the long run. In this context, policies to provide permanent competitive advantage for SMEs have become quite similar with EU member countries, and formation of European Single Market and adoption of competitive strategies for small enterprises have been supported. Actually, many proposals to enhance competitive advantage and innovation capabilities of SMEs were made in the OECD conference held in Istanbul in 2004. Besides, Turkish governments have been initiated supporting programs which for SMEs after 1980s. *On the other hand*, regional development projects prepared with conventional planning system, limited with conventional techniques, and lacking contemporary terms such as innovation, bottom-up structure, and compromise, have triggered different approaches to come up. In this respect, cluster approach has been an effective model lately for both economic development and sustainable competitive advantage of SMEs.

## Cluster Approach for Gaining Competitive Advantage

Although cluster concept is brand-new in the literature, the concept has become popular right after the publication of *Competitive Advantage of Nations (1990)* by Porter. In his work, Porter analyses different case studies from various parts of the world and contends that clusters of developed economies are the source of job, income, and export. It is also known that a similar approach was asserted by Marshall (1890); who mentions industrial concentrations (*industrial districts on textile and metalwork located in England and France*), and asserts that industrial concentration provides advantage for the firms, particularly, in terms of employment.

Despite the fact that there is no common definition of cluster, it is generally defined as the sectoral and geographical concentration of enterprises (Humphrey and Schmitz, 1995; Porter, 1998). This geographical concentration may be a country, a region or a city (Porter, 1998; Roelandt et al., 1997; Bulu and Eraslan, 2004). In addition to major firms, customized goods and service suppliers, customized infrastructure suppliers, customized training, research and technical support institutions such as universities, think-tanks, vocational education institutions, standard-setting institutions, commercial and occupational NGOs, and other players may also take place in clusters (Porter, 1998). In other words, a cluster can be defined as the network and concentration of players (*enterprises and firms producing goods and/or services, suppliers, competing and/or complementary firms, specialized infrastructure providers, control and certification institutions, local government, central government, financial institutions and/or establishments, media, knowledge producing* *institutions, R&D institutions and/or firms, sectoral non-governmental organizations*) that function bilaterally for a common purpose in the value chain of a product and/or service.

Cluster-based regional development, which provides firms the required infrastructure to gain competitive advantage through outsourcing, is in fact the systemic and systematic management of the value chain. The main aim here is to manage the cluster participants in a synchronized effective and efficient way as if they are members of an orchestra. The more a cluster suffers from lack or gap of communication, the less competitive it is. Additionally, some other variables also affect the competitive advantage of a cluster in a positive and/or negative way. Competitive advantage of a sector and economic development of a region can be achieved through an effective cluster development (Nasır, Bulu and Eraslan, 2007). Another major issue wondered about the cluster is its formation process. Cluster-type structures generally emerge as a result of degree of closeness and/or ownership of raw-material, geographic structure and a planned government policy. A cluster can be formed in case of the existence of one of above-mentioned variables.

Possessing the raw material is one of the major factors of a cluster formation for a region and/or country. For instance, the rich marble reserves Italy possesses, have led the way for very developed marble clusters in Italy. Today, the Carrara district of Italy, with thousands of workers, stands out as one of the developed clusters in terms of natural stone industry. In addition to rich marble and reserves, Italy is the center of production and processing technology. On the other hand, the term raw material here may imply another factor. For instance, Sultanahmet district of Istanbul has become one of the most important culture and history clusters of Turkey thanks to many rich historical and cultural heritages (Nasır, Bulu and Eraslan, 2007). Another important factor for the cluster formation is the appropriateness of the climate and geographic structure of the country and/or region. Being in the conjunction of the main roads, locating by the sea and or a lake, and possession of savannas and wetlands are some of the elements that clusters ground on. For instance, the long, convenient and off the ocean coasts of Norway brought on the formation of a developed maritime transportation cluster in Norway. In spite of its small population, Norway performs the 10% of world maritime transportation in average. Likewise, the appropriate climate of Denizli (*a small city of western part of Turkey*) reduces the climatic cost of home textile industry to zero. Knowledge, social features, and economic conditions of the society also play important role in the cluster formation process. The socio-cultural structure of Germans is an important factor for the Heidelberg Printing Cluster (Porter, 1990). The geographic closeness of information technology (IT) firms to Turkish capital city's universities, such as Middle East Technical University (METU), Bilkent, and Hacettepe, has provided them a large qualified labor pool and led to a developed IT cluster (Bulu, Eraslan, and Şahin, 2004).

## Relationship among Cluster, SMEs, and Competitive Advantage

As it is known, enterprises that possessed basic raw materials used to have the market advantage in the past. However, today, rather than firms solely possessing raw materials, firms that utilize resources more effective than competitors are able to compete and keep its presence. It is quiet possible to come across with clusters of interrelated firms when the biggest economies and their most competitive sectors are analyzed (USA-Entertainment and Motion Picture Industry, Germany- Automotive Industry, Norway- Maritime Cluster, Japan– Electronics, Italy- Apparel and shoes cluster). Although all these countries once had cost disadvantage (*especially in terms of labor cost*), they have competed successfully in the above-mentioned sectors through developed clusters. Today, firms can survive in case they increase and sustain their performance against the new economic condition and the competition emerging as a result of globalization. The rapid changing environment, new technology, new global competitors, the changing demographic structure, lifestyle, and new requirements called forth enhancement of competitive advantage through the development of innovative and technological capabilities (Gök, Özşahin and Ciğerim, 2004: 280). A developed and well-managed cluster enhances and sustains the competitive advantage of firms and SMEs.

SMEs operating in clusters can benefit as if big companies or firms possessing formal connections with no need to disclaim from flexibility. Therefore, the competitive advantage of SMEs operating in a cluster is affected in ways mentioned below. *Firstly*, firms operating in clusters possess or access a pool of specialized and experienced workforce. Naturally, in such a case, those enterprises lose less time and have less lookup and transaction cost in hiring process. Clusters also provide different benefits for both employers and employees and lessens the risk of employees to work somewhere out of the cluster. Even, the cluster attracts qualified employees, thus, as is the case in large companies, SMEs solve both qualitative and quantitative side labor problems. *Secondly*, a developed cluster possesses a specialized supplier base and plays an important role in the procurement of major inputs. In other words, working in cooperation with a local supplier rather than a remote supplier would reduce transaction costs; therefore, minimizes the inventory levels and eliminates import and delay cost. Geographical closeness would also enhance communication and facilitate after-sales service for suppliers. *Finally*, all market oriented, technology-oriented and competition-oriented specialization, experience and knowledge accumulate in the cluster. Besides, personal relations and community ties build up the trust among players and accordingly, expedite flow of information; and these conditions provide a fluent basis for the flow of information.

Ties between cluster participants are bigger than the sum of all parts. In other words, the synergistic cooperation among enterprises, government bodies, training institutions, and non-governmental organizations develops through clusters. For instance, opinions of tourists are not affected solely by the environmental beauties in a typical tourism cluster but also by the quality and efficiency of complementary parts such as hotels, restaurants, shopping centers, infrastructure, and easement of access and transportation. For such a media to exist, all players must act in coordination. *Investments* such as infrastructure or training programs realized by government bodies affect the performance of enterprises. Training of employed workers in local programs reduces the training cost. Besides, investments such as training, infrastructure, quality centers and test laboratories made by the private sector, also affect the performance of other firms.
Clusters provide a local and motivating competition media. Pressure arising from the closeness to similar firms, forms a more competitive pressure than the pressure arising among non-competitive firms or firms competing indirectly. Cluster, as a natural competition media, brings in firms the desire to outrun the other firms. On the other hand, cluster members are interdependent so the good performance of a firm in the cluster affects the others in positive way.

Clusters facilitate the evaluation of firm performance through internal benchmarking. Local competitors possess some conditions such as similar labor cost and opportunity of access to local market and firms within a cluster have similar operations. Enterprises within a cluster typically have detailed information about their own suppliers. Managers can share the cost and performance ratings of employers with other local enterprises accurately, feeling more comfortable when compared to sharing with a competitor out of the cluster.

Clusters also play an important role in terms of innovation capabilities of enterprises. For instance, IT companies located in the Silicon Valley meet the requirements and requests of customers fast beyond comparison with firms located in other regions. Relations between enterprises within the same cluster help enterprises learn concepts such as technology development, access to components and machines, service, market, etc. This kind of learning is realized through visits and generally face-to-face contact. Clusters provide flexibility and capacity to act fast. A firm within a cluster can easily access a resource to use in innovation studies. Local suppliers and partners may participate in the innovation process, and this case provides fulfillment of requirements superior. In a case to the contrary, firms outside of a cluster have difficulties in activities, which must be held in coordination with remote suppliers and other organizations.

Clusters reduce the investment risk of both its members and new entrants; therefore attracts domestic and foreign investment. Entrepreneurs within a cluster may easily realize the gaps in the provision of goods and services. Moreover, entrepreneurs entering a cluster face with fewer problems compared to other places. Required assets, skills, inputs and personnel are present to be fit to the new enterprise in a cluster. Financial institutions and investors those are familiar with clusters chance a low risk. Furthermore, cluster itself stands as a major internal market, and entrepreneurs may benefit from the pre-established connections. All above mentioned factors will reduce the risk of failure. The new business within the cluster is a part of the feedback cycle. As a result, clusters expand the resource pools that members benefit. *In summary*, access to new and complementary technology, catching the synergy of cooperation, achieving common R& D and technology development projects, lessening competition through cooperation, reaping mutual benefits that come up with common information and assets, speeding up learning process, overcoming entrance barriers to the market, and ability to act like a large company does when faced with these issues, and as a result gaining competitive advantage through reducing transaction costs are some of the benefits clusters offer.

## Methodology of Research

Scientific knowledge on cluster approach is new and inadequate; therefore, qualitative research methods were adopted in this study. *The aim of this study* is to reveal the required strategies for enhancing the competitive advantage of Turkish SMEs through applying cluster approach. The study is also designed to help policy makers and executors determine priorities on how to develop such strategies for SMEs.

Primary and secondary data collection methods were used in order to fulfill the purpose of the study. As a secondary data research method, an extensive literature review was done to attain basic variables within the context of cluster approach and competitive advantage of SMEs. After determination of basic variables, the other part of the study was completed through primary resources. In this respect; group discussion, expert opinion and in-depth interview techniques were conducted. *In the phase of group discussion*, in order to obtain interaction between group members, participants were encouraged to share in their field experience and professional knowledge. In this respect, meetings were held with the participation of 15 Small and Medium Industry Development Organization of Turkey (KOSGEB) specialists who possess extensive sectoral knowledge and experience. Group discussion last approximately two hours and required information was recorded through taking notes. In order to provide a comfortable media for the participants to convey their opinions, no recording apparatus was used. After the discussion, strategies to provide competitive advantage for SMEs were developed based on cluster-based variables obtained from secondary resources. *Expert opinion*, which is a research method used to obtain experience and knowledge of experts, enables researchers to draw conclusions on plans, strategies, and policies. In this study, company officials from different sectors; related government officials, and representatives of related NGOs were asked to reply ten questions via e-mail. Additionally, participants were requested to express their opinions about the issue (200 to 300 words). One hundred and forty seven participants were included in the research in total and responds were collected in one month. *Finally*, in-depth interview method was utilized in the study as a qualitative research technique. In-depth interview method, as a popular data collection method, reveals personal perceptions, opinions, appraisals of respondents and problems and possible solutions to related issues. Therefore, an interview was done with the President of KOSGEB in order to draw out strategies for increasing cluster-based competitive advantage of Turkish SMEs. Thanks to open-ended questions, no specific opinion was imposed to respondents and a comfortable media was provided for respondents to convey their opinions.

## Competitive Strategies for SMEs with Cluster Approach

According to results, cluster based advantages for SMEs concentrate on two strategies defined by Porter; namely, (1) low cost, and (2) differentiation (Porter, 1980). In other words, not only clusters lessen the production cost of firms, but also enable firms to have a more competitive position through triggering innovation. Results also indicate that clusters provide competitive advantage for a low-cost position through (a) lower transaction cost, (b) economies of scale, and (c) operational excellence.

*Low Transaction Cost*: physical closeness of cluster participants exposes the cooperation culture among firms. Thereby, procurement of goods and/or service among enterprises is realized faster and much more accurately. Besides, since firms are well aware of the capacity and the quality of supply other firms can provide, clusters lessen the transaction cost. Therefore, an SME giving priority to the supplier within the cluster gains competitive advantage. If suppliers of specific inputs are absent in the cluster, attempts to attract those suppliers to the cluster would enhance the competitive advantage of other firms within the cluster.

*Economies of Scale*: when necessary, clusters behave as if they are large companies. For instance, when a cluster participant that is close to end consumer takes a large order, portions out this order among firms operating in the value chain and in the same cluster. In this way, the cluster participant is able to deal with an order that is beyond his capabilities with the assistance of other participants of the same cluster. In such a case firms specialized on a specific component, emerge in the cluster, and these firms gain competitive advantage over competitors operating out of the cluster because those firm operating out of the cluster have problems in taking regular orders as much as the firm operating in a cluster. Even they do, they have to face higher marketing cost. Therefore, firms within a cluster benefit from economies of scale through specializing on a particular component of end product rather than producing various products.

*Operational Excellence*: firms that are forced to specialize on specific areas in a cluster, naturally progress more and more on that area. Firms are able to overcome the pressure of supplying more high quality products at a lower price under the influence of global competition through the experience gained in operational transactions. Moreover, firms operating in a cluster find the opportunity to monitor their competitors that operate in the same cluster, and the competition in between put pressure on firms to produce high quality products at a lower cost.

On the other hand, results of the study point out that differentiation which is the second variable of competitive advantage mentioned by Porter, SMEs could gain competitive advantage through differentiating in two ways; (a) triggering innovation, and (b) know-how.

*Triggering Innovation*: firms those closest to end consumers have the opportunity to track the trends in the market, and share projects that provide competitive advantage through differentiating products with other firms in the same cluster. For instance, when a mobile phone producer realizes the demand towards more everlasting monitors in the market, can demand instantly from the supplier, and the screen producer may develop the product through R& D researches. Therefore, the cluster members make innovation through cooperation. In this respect, firms operating in a cluster have the opportunity to follow market trends through the firms that are close to end user and therefore have competitive advantage over competitors operating out of a cluster.

*Knowledge*: clusters specialize on specific goods and services therefore as the time goes cluster members obtain an important level of expertise. When required, the know-how which is generally triggered by the demand of the market or the threat of competitors develops into a new product through innovation. The development process may be the result of both internal dynamics, the learning tendency and the expertise of the firm itself, and of co-operations (*common R&D researches, employer transfer, etc.*) arising within the cluster. Not only the firm benefits and gains competitive advantage through the expertise possessed, but also through cooperating firms within the same cluster.

## Conclusion and Suggestions

Policy making to gain cluster based competitive advantage has been an important issue especially since last decade. This study aims to analyze advantages, which SMEs operating in a cluster possess but SMEs operating outside a cluster do not. Results obtained from the qualitative research were assessed from the perspective of cluster approach and competitive advantage.

While advantages SMEs within a cluster possess were assessed, the issue was analyzed on the differentiation and low cost axis defined by Porter. Advantages, which cluster participants may have, were classified in five other headings under these two main headings. According to results, an SME operating within a cluster may outpace an SME operating out of a cluster through (1) Lower Transaction Cost, (2), Economies of Scale, (3) Operational Excellence, (4) Triggering Innovation, and (5) Know-How. Therefore, cluster approach cannot be disregarded by both entrepreneurs and government bodies when the issue is to develop competitive SMEs. Operating in a cluster provides advantages to the entrepreneurs who consider new investment. Value chain activities in which there is weak competition, stand as ideal investment areas in an existing cluster. SMEs competing on those activities benefit from both being a member of a cluster and high margin of profit. Therefore, not only SMEs gain sustainable competitive advantage through being a member of a cluster but also operate with high profit margins.

Cluster approach provides effective and efficient utilization of public resources in the course of provision of policies regarding the sustainable competitive advantage of SMEs. SMEs can gain competitive advantage through development of sector-based clusters and orientation of investors to those clusters. Thus, incentives given to SMEs should be arranged to attract investments to weak part(s) of value chains in clusters. Moreover, within their zone of responsibility, local authorities should make policies to develop specific clusters rather than try to attract investors from various sectors. Attracting cluster-related investors to the area would help to increase the competitive advantage of the city or county on a specific sector.

Although this study is prepared within the framework of cluster approach and competitive advantage, results are Turkey specific as a consequence of Turkey-specific data used. Therefore, further studies should be conducted in other countries to obtain universal validity.

# REFERENCES


- Akgemci, T., (2001), *KOBİ'lerin Temel Sorunları ve Sağlanan Destekler*, KOSGEB Yayınları, Haziran.
- Alasrag, H., (2006), *Enhancing Competitiveness For SMEs in the Arab Countries*, Munich Personal Repec Archive (MPRA), November, MPRA Paper No.4110.
- Alderson, W., (1965), *Dynamic Marketing Behaviour: A Functionalist Theory of Marketing*, Homewood, Il: Richard D. Irwin, Inc.
- Alpugan, O., (1988), *Küçük İşletmeler Kavramı: Kuruluşu ve Yönetimi*, Karadeniz Teknik Üniversitesi Basımevi, Trabzon.
- Atik, H., and Sezer, S., (2001), *Avrupa Birliği'ne Entegrasyon Sürecinde Küçük ve Orta Boy İşletmelerin Sorunları: Kayseri ve Nevşehir Örneği*, I. Orta Anadolu Kongresi:Kobi'lerin

Finansman ve Pazarlama Sorunları, Nevşehir: Erciyes Üniversitesi Nevşehir İktisadi ve İdari Bilimler Fakültesi, 18-21 Ekim, pp: 107- 116.

- Aydemir, Z.C., (2002), *Bölgesel Rekabet Edebilirlik Kapsamında İllerin Kaynak Kullanım Görece Verimlilikleri: Veri Zarflama Analizi Uygulaması*, DPT Uzmanlık Tezleri, Yayın No: Dpt 2664, Devlet Planlama Teşkilatı, Ankara.
- Balçık, B., (1997), Küçük İşletmelerin Ekonomiye Katkılan ve Ülkemizde Küçük İşletmelere Hizmet Götüren Örgütler, *Atatürk Üniversitesi İktisadi İdari Bilimler Fakültesi Dergisi*, C 11, S 3-4, Nisan.
- Barney, J., (1991), Firm Resources and Sustained Competitive Advantage, *Journal of Management*, Vol 17, No 1, pp: 99- 120.
- Baykal, N.A., and Güneş, E., (2004), Effectiveness of SMEs in Turkish Economy and Agricultural Industry Sector, *International Journal of Management Enterprise Development (IJMED)*, Vol 1, No 4, pp: 359- 374.
- Bulu, M., Eraslan, I.H., and Karataş, A., (2007), *The Analysis of International Competitiveness Level of Turkish Leather Industry*, 3rd International Strategic Management Conference, 21-23 June, Antalya.
- Bulu, M., Eraslan, İ.H., and Kaya, H., (2006), Türk Elektronik Sektörünün Rekabetçilik Analizi, *İstanbul Ticaret Üniversitesi Sosyal Bilimler Dergisi*, Sayı 9, Yıl 5, Bahar.
- Bulu, M., Eraslan, İ.H., ve Şahin, Ö., (2004), *Elmas (Diamond) Modeli İle Ankara Bilişim Kümelenmesi Rekabet Analizi*, 3.Ulusal Bilgi, Ekonomi ve Yönetim Kongresi, 25- 26 Kasım, Eskişehir.
- Bulu, M., ve Eraslan, İ.H., (2004), *Kümelenme Yaklaşımı*, İsmail Bakan (Ed.), Çağdaş Yönetim Yaklaşımları: İlkeler, Kavramlar Ve Yaklaşımlar, Beta Basım Yayım Dağıtım A.Ş., İstanbul.
- Coskun, A., (2004), *Motors of Innovation and Development*, Second OECD Ministerial Conference on SMEs, OECD Observer No 243, May.
- Çelik, A., (1999), *Kahramanmaraş'ta Girişimcilik Kültürü Araştırması*, Kahramanmaraş Ticaret ve Sanayi Odası, Yayın No. 1999/1.
- Çınar, A., (2005), Rekabet ve Verimlilik İlişkisi, *İstanbul Ticaret Odası Gazetesi*, 13 Mayıs.
- Day, G.S., and Wensley, R., (1988), Assessing Advantage: A Framework for Diagnosing Competitive Superiority, *Journal of Marketing*, Vol 52, April, pp: 1- 20.
- Depperu, D., and Cerrato, D., (2005), *Analyzing International Competitiveness at the Firm Level: Concepts and Measures*, Quaderni Del Dipartimento Di Scienze Economiche E Sociali, Università Cattolica Del Sacro Cuore – Piacenza, 32.
- Devlet Planlama Teşkilatı (DPT), (2004), KOBİ Stratejisi ve Eylem Planı, DPT Yayınları, Ocak.
- Dinçer, Ö., (1996), *Stratejik Yönetim ve İşletme Politikası*, Beta Basım Yayım Dağıtım A.Ş., İstanbul.
- Ekin, N., (1993), Gelişen Ülkelerde ve Türkiye'de Bir İstihdam Politikası Olarak Küçük Ölçekli İşyerlerinin Teşviki, İTO Yayınları, No: 93/34, İstanbul.
- Enright, M.J., and Ffowcs-Williams, I., (2001), *Local Partnership, Clusters and SME Globalization, Territorial Development Service*, OECD.
- Erdil, O., İmamoğlu, S.Z., and Keskin, H., (2003), Küçük ve Orta Boy İşletmelerde (KOBİ'lerde) Ürün Yeniliği ve Ar-Ge Faaliyetleri, *Marmara Üniversitesi Sosyal Bilimler Enstitüsü Öneri Dergisi*, Cilt 5, Yıl 9, Sayı 19, Ocak.
- Eren, E., (2002), *Stratejik Yönetim Ve İşletme Politikası*, Beta Basım Yayım Dağıtım A.Ş., İstanbul.
- Erkan, H., (1997), *Bilgi Toplumu ve Ekonomik Gelişme*, Üçüncü Baskı, Türkiye İş Bankası Kültür Yayınları, No. 326, İstanbul.
- Erkumay, M.A., (2000), KOBİ'lerin Sermaye Piyasası Olanaklarından Faydalandırılması, Sermaye Piyasası Kurulu, Yeterlik Etüdü, Ekim, Ankara.
- Goker, H.A., (1998), SMEs and Technological Innovation Policies: Some Country Examples NATO Arw, Innovation and Market Globalization: The Position of SMEs, Samarkand, Uzbekistan, September, pp: 20- 22.
- Gök, M.Ş., Özşahin, M., and Ciğerim, E., (2004), *Rekabet Edebilirlik ve Firma Performansı İlişkisi Üzerine Bir Saha Araştırması*, 12. Ulusal Yönetim ve Organizasyon Kongresi, 27-29 Mayıs, Bursa.
- Hall, W.K., (1980), Survival Strategies in a Hostile Environment, *Harvard Business Review*, 58, September-October, pp: 75- 85.
- Henderson, B., (1983), The Anatomy of Competition, *Journal of Marketing*, Vol 47, Spring, pp: 7-11.
- Humphrey, J., and Schmitz, H., (1995), *Principles for Promoting Clusters and Networks of SMEs*, Unido Small and Medium Enterprises Branch, Number 1.

- Koyuncu, M., (1998), *Küçük ve Orta Büyüklükteki İşletmelerin Rekabet Stratejileri ve Kayseri'de bir Araştırma*, İstanbul Üniversitesi, Sosyal Bilimler Enstitüsü, Basılmamış Doktora Tezi, İstanbul.
- Kumar, R., and Chadee, D., (2002), *International Competitiveness of Asian Firms: An Analytical Framework*, ERD Working Paper No 4, Asian Development Bank.
- Kumral, N., (2006), *Bölgesel Rekabet Gücünü Artırmaya Yönelik Politikalar*, Bölgesel Kalkınma ve Yönetişim Sempozyumu, Türkiye Ekonomi Politikaları Araştırma Vakfı (TEPAV/ EPRI), Orta Doğu Teknik Üniversitesi (ODTÜ), 7-8 Eylül.
- Küçükçolak, R.A., (1998), *KOBİ'lerin Finansman Sorununun Sermaye Piyasası Yoluyla Çözümü*, İMKB Yayınları, İstanbul.
- Landaboaso, M., (2001), *Clusters and Less Favoured Regions: Policy Options in Planning and Implementation*, European Commission.
- Marshall, A., (1890), *Principles of Economics*, Macmillan & Co, London.
- Moon, H.C., and Peery, N.S., (1995), Competitiveness of Product, Firm, Industry, and Nation in a Global Business, *Competitiveness Review*, Vol 5, No 1, pp: 37- 43.
- Nasır, A., Bulu, M., and Eraslan, İ.H., (2007), *The Analysis of Tourism Cluster Development of Istanbul: A Longitudinal Study in Sultanahmet District (Old Town)*, Rob Macgregor, Ann T. Hodgkinson (Ed.), Small Business Clustering Technologies: Applications in Marketing, Management, It, and Economics, Information Science Publishing.
- Nonaka, I., 1991. The Knowledge- Creating Company, *Harvard Business Review*, November-December, pp: 2- 9.
- Oktav, M., Önce, G., Kavas, A., and Tanyeri, A., (1990), *Orta ve Küçük İşletmelerde İhracata Yönelik Pazarlama Sorunları ve Çözüm Önerileri*, TOBB Yayını, No 176, Ankara.
- Oktay, E., and Güney, A., (2002), *Türkiye'de KOBİ'lerin Finansman Sorunu ve Çözüm Önerileri*, 21. Yüzyılda KOBİ'ler: Sorunlar, Fırsatlar Ve Çözüm Önerileri Sempozyumu, 3-4 Ocak, Doğu Akdeniz Üniversitesi.
- Ören, K., (2003), Avrupa Birliği ve Türkiye'nin Küçük ve Orta Büyüklükteki İşletmelere (KOBİ) Sağladığı Devlet Teşvikleri ve Kullanım Alanlarının Karşılaştırılması: Nevşehir İli'nde Bir Uygulama, *C.Ü. İktisadi ve İdari Bilimler Dergisi*, Cilt 4, Sayı 2.
- Özkan Ş., Gündoğdu, F., Emsen, S., Aksu, H., and Başar, S., (2003), *KOBİ'lerde Girişimcilik-Yenilikçilik: Türkiye'de Gelişmiş ve Azgelişmiş Bölge Düzeyinde Bir Analiz*, Atatürk Üniversitesi Yayınları, No.929, Araştırma Serisi, No 90.
- Özok, A., (1993), *Küçük ve Orta Ölçekli İşletmelerde Rekabet Gücü Açısından Verimli Çalışma*, Sanayi Kongresi Bildiriler Kitabı, I. Cilt, TMMOB.
- Palas, A., (1996), *Dünyada ve Türkiye'de KOBİ'lerin Gelişimi*, Küçük ve Orta Ölçekli Sanayii Verimlilik ve Teknoloji Analizleri Semineri, Ankara.
- Pınarcıoğlu, M., (2000), Kolektif Verimlilik ve Sorunları, *Toplum ve Bilim*, Güz, Sayı 86.
- Porter, M.E. (1990), *The Competitive Advantage of Nations*, The Macmillan Press Ltd., London and Basingstoke.
- Porter, M.E. (1998), The Adam Smith Address: Location, Clusters, and The New Economics of Competition, *Business Economics*, January.
- Porter, M.E., (1980), *Competitive Strategy*, Techniques for Analysing Industries and Competitors, The Free Press, New York.
- Porter, M.E., (1985), *Competitive Advantage: Creating and Sustaining Superior Performance*, The Free Press, New York.
- Porter, M.E., (1990a), The Competitive Advantage of Nations, *Harvard Business Review*, March-April, pp: 73- 93.
- Prahald, C.K., and Hamel, G., (1990), The Core Competence of Corporations, *Harvard Business Review*, May- June, pp: 79- 91.
- Roelandt, T.J.A., Den Hertog, P., Van Sınderen J., and Vollaard, B., (1997), *Cluster Analysis and Cluster Policy in the Netherlands*, Position Paper, Paper Presented at OECD- Workshop on Cluster Analysis and Cluster Based Policy, 10-11 October, Amsterdam, Netherlands.
- Sanayi ve Ticaret Bakanlığı Küçük ve Orta Ölçekli Sanayi Geliştirme ve Destekleme İdaresi Başkanlığı (KOSGEB), (2008). Yıllık Raporlar ve İstatistiksel Veriler, KOSGEB Yayınları, Ankara.
- Sarıaslan, H., (1996), *Türkiye Ekonomisinde Küçük ve Orta Büyüklükteki Sanayi İşletmeleri: İmalat Sanayi İşletmelerinin Sorunları ve Yeni Stratejiler*, TOBB Yayınları, No 35, Ankara.
- Schumpeter, J.A., (1934), *The Theory of Economic Development*, Harvard University Press, Cambridge, Ma.
- Senge, P.M., (1990), *The Fifth Discipline: The Art and Practice of the Learning Organization*, Double Day/ Currency Press, New York.

- Şenyurt, D., (1995), *KOBİ'lerin Avrupa Topluluğu'nda ve Türkiye'de Teşviki*, Türkiye Giyim Sanayicileri Derneği & Interbank Yayını.
- Teece, D.J., Pisono, G., and Shuen, A., (1997), Dynamic Capabilities and Strategic Management, *Strategic Management Journal*, Vol 18, pp: 509- 533.
- Türkiye İstatistik Kurumu (TÜİK), (2008), Yıllık Raporlar ve İstatistiksel Veriler, Retreived from, htpp://www.tuik.gov.tr
- Ülgen, H., and Mirze K., (2004) *İşletmelerde Stratejik Yönetim*, Literatür Yayıncılık Ltd., İstanbul.
- Wolf, A., and Musaoğlu, N., (2002), *Avrupa Birliğine Uyum Sürecinde KOBİ'lerin Karşılaştıkları Sorunlar ve Çözüm Önerilerinin Belirlenmesi: Sakarya İlinde Yapılan Araştırma Örneği*, 21. Yüzyılda KOBİ'ler: Sorunlar, Fırsatlar ve Çözüm Önerileri Sempozyumu, Doğu Akdeniz Üniversitesi İşletme ve Ekonomi Fakültesi, 3-4 Ocak.
- Yücel, T., (2001), *Küçük ve Orta Ölçekli İşletmelerde Çalışma Sermayesi ve Finansal Yönetim Uygulamaları*, I. Orta Anadolu Kongresi: KOBİ'lerin Finansman ve Pazarlama Sorunları, Erciyes Üniversitesi Nevşehir İktisadi Ve İdari Bilimler Fakültesi, Ekim, Nevşehir.

# PUBLIC–PRIVATE PARTNERSHIPS: THEORY AND PRACTICE IN GLOBAL PERSPECTIVE

**M. Turan Çuhadar**
**Deputy Governor of Ordu Province, Turkey**

## ABSTRACT

*This paper aims to investigate public–private partnerships (PPPs) theory and practice in global perspective. Public–private partnerships are now a common strand of third way government policy, with better efficiency promised from the private funding of public infrastructure through the transfer of risks to private parties (Australia 2004). In the past, it was observed that most countries spent their valuable but limited resources on unproductive and misdirected populist policies. Meanwhile, various investment models have been tried by the democratic and developed governments around the world to tackle the problem of funding in the infrastructure sector. Moreover, deep economic crises forced these developed countries to restructure their economies with vital emphasis on fiscal discipline and strategic investments. PPPs represent a new form of network governance, potentially offering flexibility, economic efficiency, deciding together- acting together and non-governmental participation in policy development.*

***Key words***: *PPP, public private partnership, governance, infrastructure investment, privatisation.*

## INTRODUCTION

PPPs have enjoyed a global resurgence and have become icons of modern public administration. This paper looks at the PPP phenomenon and the global experience of one type of partnership arrangement – that of long-term infrastructure contracts. The objective of PPPs is to establish a partnership between the public and private sectors to deliver services to the public. In recent decades local/state governments in most countries promote co-operation between the public and private sectors in providing public goods. Governments realise that their limited financial resources are not sufficient to cover the required expansion of some infrastructure services such as motor/doubled way, dam, airport, sanitation, energy and other services. Local governments are finding that their tax revenues are not providing sufficient resources to meet these needs, and official development assistance has not been able to fill the gap. One of the most viable options is to involve PPP which describes a spectrum of possible relationships between public and private actors for the cooperative provision of infrastructure services. This cooperation takes the form of PPP arrangements, in which the functioning principles of private firms are implemented in public administration. Such PPP arrangements were driven by limitations in public funds to cover investment needs but also by efforts to increase the quality and efficiency of public services.

## PPP IN THEORY

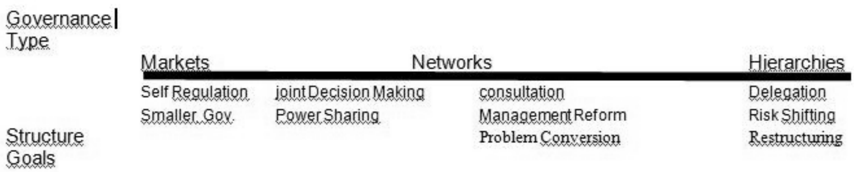
Even though PPPs have a long history in Anglo-American countries, especially in the UK and USA, there has been a surge in their number all over the world since last two decades. According to Pongsiri, PPP is an appropriate institutional mechanism for correcting market failures by introducing 'equity, and mutual accountability' (Pongsiri, 2002). Especially, this corrective understanding of PPPs is used by 'Third Way' governments in Germany and Britain to underpin such 'collaborative' arrangements (Linder and Rosenau, 2000). This policy change aims at reducing the opposition at local level as well as at national level (Mcquaid, 2000). It is claimed that these are different from privatizations in 1980s since risks and responsibilities are diffused to each participator of partnership. In that sense, this is cooperative inter-organizational form in which the differences between public and private become blurred (Linder and Rosenau, 2000).

From 1992 onwards, the Conservative Government, ruling in the UK at those times, set out to promote the use of private finance in public sector projects, with private investors expecting to take on as much risks as possible. From 1994**,** local authorities were encouraged to use private finance for their capital projects In 1995**,** some of -the restrictions in the 1989 legislation were lifted for this type of Project.

Outsourcing, privatisation and partnerships between business and government transfer cost and risk from the public to private sector. The adoption of PPPs raises several significant issues for public affairs. First of these issues relates to the proper place and role of business in the political environment. The second relates to the potential that PPPs have for undermining public confidence in the independence of government from the private sector (Leitch, Motion, 2003).

The meaning of partnership is ‘deciding together’ and ‘acting together’ as stated in the saying of Franceys and Weitz (2003) interpretation They have also accentuated that “the internationally promoted ‘vehicle’ for reform and institutional development for the past decade has been ‘privatization’ (though there it could be questioned whether in previous times ‘nationalization’ had served a similar role in needed reform or not)”. Some writers advocate that partnerships as a new form of governance representing a third way to govern relations in society (Hofmeister and Borchert, 2004; Klijn and Teisman, 2000; McLaughlin and Osborne, 2000; Teisman and Klijn, 2003). Stephen Linder and Pauline Rosenau identify six forms of PPPs, but they look at the rationale behind their use rather than analysing their structure.

***Figure 1.* Governance Continuum**




*1. Power sharing.* A form of *joint decision-making*. (2) *Risk shifting* and (3) *restructuring public services.* Forms of *delegation*. In risk shifting, the private sector assumes some financial risks for a project in exchange for profit (some argue that businesses, with their specialized knowledge, can adopt a project at a lower cost, so risk transference ends up costing the government very little; others disagree). Public-service restructuring generally involves contracting out services and giving government more ‘flexibility’ with its workforce. (4) *Management reform*, (5) *problem conversion*, and (6) *moral regeneration*. Forms of *consultation*. These three rationales involve changing the way bureaucracies approach policy problems. Whether it means an ideological change (use of more market-based principles of management, as implied in New Public Management) or refocusing on new types of problems, the structure of bureaucracies remains relatively consistent (Linder and Rosenau, 2002).

PPPs are loosely defined as co-operative institutional arrangements between public and private sector actors, but few people agree on what a PPP actually is. So what are PPPs, and if governments have long had a relationship with business, what is really so different about today’s version of PPP? To answer these questions requires an understanding of the PPP as a phenomenon rather than a single technique. In fact, the PPP phenomenon is a set of governance tools as well as a set of language games, and both have long historical pedigrees. History indicates that there has always been some degree of public sector and private sector co-operation (Hodge and Greve; 2009).

In literature, various models or instruments of privatization are stated. Privatization can be used by constituting a scale classifying from ‘strong’ to ‘weak’ one. The first one is sale of assets to private sector via ‘restitution, give away or liquidation’ (Weizsacker et. al, 2005). The second one is ‘build-operate-transfer’ in which ownership is temporarily transferred to private company. The last one is the PPPs in which ownership remains in public but responsibilities, risks, gains and duties are shared among participators.

# Table 1: Selected PPP evaluations over the past decade

| Study | Sample/Cases | Country | Type of publication | Better VfM? | Comments/Conclusions |
|---|---|---|---|---|---|
| Bloomfield *et al.* (1998) | A Massachusetts correctional facility | United States | Case study | No | • 7.4% more expensive through P3 lease purchasing<br>• 'inflated sales pitches' camouflaged real costs and risks to the public, and the project was 'wasteful and risky' |
| Arthur Andersen & LSE Enterprise (2000) | 29 business cases analysed | United Kingdom | Initial evaluation | Yes | • 17% cost savings estimated against the PSC<br>• risk transfer accounted for 61% of forecast savings |
| Savas (2000, p. 240) | General observations | United States | Literature review | Yes | • '[the private sector through PPPs] build more quickly and more cost effectively than governments usually can . . .' |
| National Audit Office (2000) | 7 business cases from NAO (2000) | United Kingdom | Business cases | Yes | • 10–20% cost savings estimated |
| Walker and Walker (2000, p. 204) | General observations of Australian cases | Australia | Literature review | – | • PPP infrastructure financing deals seen as 'misleading accounting trickery' with eroded accountability to Parliament and the public<br>• private project consortium real rates of return were up to 10 times those returns expected for the public |
| Teisman and Klijn (2001) | General observations | 4 EU countries | Review of strengths and weaknesses | – | • PPPs have strengths and weaknesses |
| DoT (2002) | 250 London Underground projects (1997–2000) | United Kingdom | Unknown | – | • Cost over-runs averaging 20% were found |
| Mott Macdonald (2002) | 39 traditional projects and 11 PFI projects selected | United Kingdom | Multiple cases reviewed | Yes | • Traditional 'public' infrastructure provision arrangements were on-time and on-budget 30% and 27% of the time, but PFI-type partnerships were on-time and on-budget 76% and 78% of the time, respectively |
| Pollock *et al.* (2002) | 3 NHS hospitals and 8 trusts | United Kingdom | Review and re-analysis | No | • The PFI justification is a 'sleight of hand' |
| Pollitt (2002) | 10 major PFI cases | United Kingdom | Review of National Audit Office cases | Yes | • the best deal was probably obtained in every case, and good value for money was probably achieved in 8 of the 10 cases |
| Audit Commission (2003) | 10 traditional and 8 PFI schools were compared | Scotland | Audit report | No | • 'We found no evidence that PFI projects delivered schools more quickly than projects funded in more conventional ways'<br>• 'The public sector comparator has lost the confidence of many people . . .' |
| Greve (2003) | Case study of Farum Municipality | Denmark | Case analysis | No | • PPP assessed as 'the most spectacular scandal in the history of Danish Public Administration'<br>• It resulted in raised taxes for the citizens of Farum, higher debt for citizens and a former mayor currently on trial in the courts |
| Fitzgerald (2004) | 8 PPP cases from Victoria | Australia | Report to government | Uncertain | • The superiority of the economic partnership mode over traditional delivery mechanisms was dependent on the discount rate adopted in the analysis<br>• Opposite conclusions were reached when using an 8.65% discount rate at one extreme (where the PPP mechanism was 9% cheaper than traditional delivery) compared to an evaluation adopting a 5.7% discount rate (where the PPP mechanism was 6% more expensive) |
| Edwards *et al.* (2004) | 8 cases from roads and 13 hospital case studies | United Kingdom | Case reviews and interviews | No | • Contracts reviewed 3 years in<br>• 'PFI is an expensive way of financing and delivering public services . . .'<br>• 'the chief beneficiaries are the providers of finance and some of . . . the private sector service providers . . .' |
| Ghobadian *et al.* (2004b, p. 300) | General observations | United Kingdom | Literature review | – | • 'we have no firm evidence that the current PFIs would deliver on their long-term objectives . . .' |
| Grimsey and Lewis (2004, pp. 81, 245) | Selected global observations across several sectors | Several countries | Literature review | Yes | • 'preliminary evidence does seem to indicate strongly that PPPs offer one solution to the public procurement problem . . .'<br>• 'there is not one "model" of a PPP . . .' |
| Pollitt (2005) | General observations of UK cases plus 5 cases | United Kingdom | Literature review | Yes | • 'it seems difficult to avoid a positive overall assessment' |
| Shaoul (2005) | General observations of UK cases | United Kingdom | Literature review | No | • PFI has turned out to be very expensive with a lack of accountability<br>• Suspects that PFI policies 'enrich the few at the expense of the majority and for which no democratic mandate can be secured' |
| Boardman *et al.* (2005, p. 186) | 5 North America cases covering roads, waste management and water desalination | Canada and United States | Case reviews | No | • unless contracts both compensate the private sector for risks and then ensure that they actually bear it, 'P3s will not improve allocative efficiency' |

**Table 1:** *Continued*

| Study | Sample/Cases | Country | Type of publication | Better VfM? | Comments/Conclusions |
|---|---|---|---|---|---|
| Hodge (2005, p. 327) | General observations of UK cases plus 3 cases | Australia | Literature review | Uncertain | • There have been no rigorous and transparent evaluations of all Australian PPPs<br>• The few available assessments suggest mixed performance to date<br>• Government has moved away from its traditional stewardship role to a louder policy advocacy role, and now faces multiple conflicts of interest (as advocate, developer, steward, elected representative, regulator, contract signatory and planner) |
| Auditor-General of New South Wales (2006) | Construction of 19 schools in New South Wales | Australia | Audit report | Yes | • Between 7% and 23% cheaper<br>• Auditor saw as 'persuasive' the business case for these two PFI contracts |
| Pollock *et al.* (2007) | Re-analysis of Mott Macdonald and other reports | United Kingdom | Academic paper | No | • 'there is no evidence to support the Treasury cost and time overrun claims of improved efficiency in PFI' . . . [estimates being quoted are] 'not evidence based but biased to favor PFI . . .'<br>• only one study compares PFI procurement performance, and 'all claims based on [this] are misleading' |
| Allen Consulting Group (2007) | Sample of 21 PPPs and 33 traditional projects | Australia | Consulting report | Yes | • PPPs reported as being an 11% cheaper alternative to traditional projects<br>• Research project funded by Australia's infrastructure suppliers |
| Blanc-Brude *et al.* (2006) | 227 new road sections across 15 EU countries, of which 65 were PPPs | European Union | 31 regression analyses | Not tested | • *Ex-ante* construction costs of PPPs were 24% higher than traditional procurement<br>• This is a similar magnitude to the traditional cost over-runs<br>• Whether PPPs deliver lower overall life-cycle costs remains unknown |
| Leviakangas (2007, p. 211) | A Finnish toll-road case study | Finland | Financial models | No | • The hypothesis that private finance enabled welfare gains to be achieved was not confirmed |

***Figure 2.*** Theoretical Foundations of PPPs

PPP arrangements have become widespread for the last two decades all over the world. These arrangements today are widely used in technology, energy, education, transportation (especially motor/doubled way), dam, airport, sanitation,….and the like.

Partnerships are collaboration between parties rather than competition among them to achieve mutual benefit and this mutual benefit can be achieved by trust (Mcquaid, 2000). In that sense, it is claimed that the theoretical foundations of principal-agent theory and transaction cost economics for competition are not appropriate for PPPs (Entwistle and Martin, 2005).

Osborne and Gaebler claimed that states are better than private sector at 'policy management, regulation, ensuring equity, preventing discrimination or exploitation, ensuring continuity and stability of services, and ensuring social cohesion'. Private sector is better at 'performing economic tasks, innovating, replicating, successful experiments, adapting to rapid change, abandoning unsuccessful or obsolete activities, and performing complex or technical tasks'(Osborne and Gaebler, 1993). Partnerships are not zero-sum game but instead, they are win=win games, according to its proponents.

PPPs are composed of 'formally autonomous but functionally interdependent organizations' (Radin, 1998). For some scholars, such a complexity of service also led governments to find private partners in order to benefit from their expertise and skills (Keating, 1998). It is claimed that public administrators should learn these abilities from their business partners (Linder, 2000).

# PPP, Why?

In the past, it was observed that developing countries spent their valuable but limited resources on unproductive and misdirected populist policies. Political and administrative immaturity was also effective in nonproductive investment. Deep economic crises forced these developing countries to restructure their economies with vital emphasis on fiscal discipline and strategic investments. One of the strategic and most important investment areas was infrastructure development. Today, with the continuing drive to a global economy, democratic governments are trying to link more closely their public and private corporations in an effort to make their infrastructures more effective. This activity has been referred to as centripetal politics that occurs with a centrifugal (or complexifying) society. To do this, they look toward joint ventures that bind the two types of organizations together as PPPs (Yolles and Iles 2006).

As they experience social complexification, governments tend to perceive that they are not able to run their state infrastructure adequately. This inadequacy is illustrated by Savas (1982) who argues that the infrastructure and distribution of social goods is performed by inefficient, inflexible and irresponsible public corporations. For Claver et al. (1999), public corporations have a tendency for pathological ailments that inhibit effectiveness, and these include:

- authoritarian management style with a high degree of control;
- little communication;
- univocal top–down management;
- limited scope for individual initiative, with an orientation towards obedience and the provision of orders;
- centralized decision-making process that tends to be repetitive;
- reluctance to start innovative processes;
- high degrees of conformity;
- high level of resistance to change.

Contrary to popular belief, saving money is not the main reason behind public sector's attraction to PPPs. Respondents to the survey cited access to market skills and expertise as the most important reason. Clearly, the partnerships are not only driven predominantly by cost considerations but also reasons for public sector entering into partnerships are improved quality, cost savings, managing demand fluctuations innovation and technological change and better accountability (Domberger and Fernandez 1999).

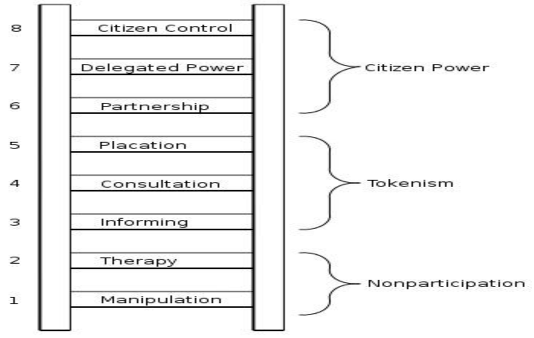
Partnering adds value. PPPs enable society to create superior solutions to many complex problems than could ever be achieved by the individual sectors separately. The value that is created accrues to each of the collaborators individually and to society collectively. It makes business sense to collaborate, and we turn next to the motivation that makes this idea reality. We consider first the special historical case where urban governance partnerships were forced into existence by urban crises, then the more regular experience of strategically motivated alliances (Austin, J., Mccaffrey, A. 2002). The most common motive cited in the literature for the genesis of modern PPPs in American cities is economic development, particularly in cities with a deteriorating inner core, or suffering the decline of de-industrialization (DiGaetano, 1997; Dowding, et al., 1999; DiGaetano & Lawless, 1999; Kantor, et al., 1997; Keating, 1993; Stone, 1993). According to Keating (1993), the drivers for this alignment of interests include the need of private sector for public powers in order to develop in cities, dependence of cities on the availability and mobility of capital, and the need of a development coalition to attract private investment capital.

With regard to sustainable development, PPPs can help in cases here more groups are involved in the political process – this means PPPs involving network governance. However, it remains unclear whether developing countries such as Hungary can successfully adopt the types of partnership necessary to break down hierarchies and bring about more dynamic government or not. Arguably, the national government does not yet have the strength to initiate network governance properly. Perhaps for this reason, partnerships between government and industry are formal and contractual, without much leeway for joint decision-making (Regéczi, 2005)

## Steps to reach to PPP?

Citizen participation approach development will help to reach to PPPs. The power structures in society will interact it.

***Figure 3.*** Eight rungs on the ladder of citizen participation (Arnstein, 1969)




(1)Manipulation and (2) Therapy: These two rungs describe levels of "non-participation" that have been contrived by some to substitute for genuine participation. Their real objective is not to enable people to participate in planning or conducting programs, but to enable powerholders to "educate" or "cure" the participants. Rungs 3 and 4 progress to levels of "tokenism" that allow the have-nots to hear and to have a voice: (3) Informing and (4) Consultation. When they are proffered by powerholders as the total extent of participation, citizens may indeed hear and be heard. But under these conditions they lack the power to insure that their views will be heeded by the powerful. When participation is restricted to these levels, there is no follow-through, no "muscle," hence no assurance of changing the status quo. Rung (5) Placation is simply a higher level tokenism because the ground rules allow have-nots to advice, but retain for the powerholders the continued right to decide. Further up the ladder are levels of citizen power with increasing degrees of decision-making clout. Citizens can enter into a (6) Partnership that enables them to negotiate and engage in trade-offs with traditional power holders. At the topmost rungs, (7) Delegated Power and (8) Citizen Control, have-not citizens obtain the majority of decision-making seats, or full managerial power. Obviously, the eight-rung ladder is a simplification, but it helps to illustrate the point that so many have missed - that there are significant gradations of participation. Knowing these gradations makes it possible to cut through the hyperbole to understand the increasingly strident demands for participation from the have-nots as well as the gamut of confusing responses from the power holders.

## Different Types of Partnerships

There are different types of contracts for establishing a partnership in the infrastructure sector. The type of the contract determines the responsibilities of each partner. These contracts are service contracts, management contracts, lease contracts, and concessions. Nevertheless, every service, management, lease contract or concession may not be a form of PPP but they can be contracting outs. PPP contracts have other characteristics such as sharing of responsibility and risk, and negotiating for the contract. Unlike the emphasis on competition as in contracting outs, public-private partnerships highlight cooperation and trust between the parties. The features of each contract may vary in different contexts due to distinct economic, institutional, social and, political background peculiar to the contexts.

## Service Contracts

This type is the least risky for private sector one among the others. It involves the short term contracts that have duration of one or two years (McDonald and Ruiters, 2005). The public authority has the responsibility for operation and maintenance of the network. Only a specific part of the system is contracted out. Therefore, private sector involvement is very limited such as ‘reading meters, repairing leaks, and mailing statements for payment’ since these contracts are performed for short-lived issues (Water Deregulation Report, 2006). The public authority has the responsibility for operation and maintenance of the network.

## Management Contracts

In management contract, private sector has more responsibility. Private sector maintains and operates the system. Usually, management contracts do not require private sector investment; therefore, there is no commercial risk (Water Deregulation Report, 2006). The central or local government takes the financial responsibility for the system. Also, there is no ‘direct legal relationship’ between citizen and private operator. There is no reimbursement if private operator does not collect fees from the citizens (Water Deregulation Report, 2006). Public authority monitors the private operator. The time duration of management contracts is between two and ten years (McDonald and Ruiters, 2005).

## Lease Contracts

In lease contract, private operators rent the facilities owned by the public authorities. The ownership belongs to the public authority and public authority is also liable for ‘system finance and expansion’, whereas private operator is ‘responsible for financing working capital and accepts some commercial risk in the day-to-day operation of the system’ (Water Deregulation Report, 2006). The operator tries to maximize fee collection so as to pay its rent fee, and make profit. Its time-span is more than ten years (McDonald and Ruiters, 2005).

## Concessions

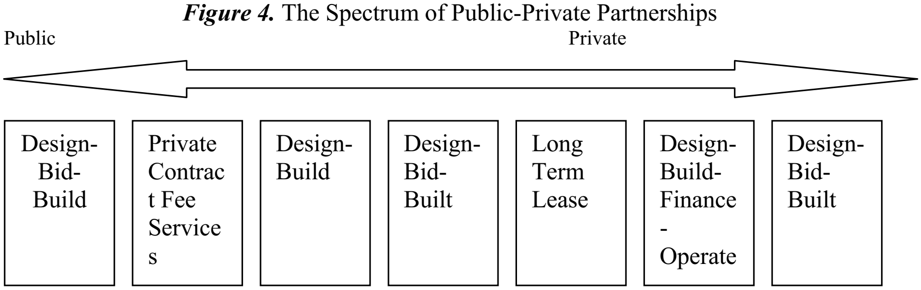
Concession is a long term contract covering a period of twenty five to thirty years (McDonald and Ruiters, 2005). In this contract, private contractor do investments in the system. Concessionaire has overall responsibility about the system, 'including operation, maintenance, and management as well as capital investments during the concession period' (McDonald and Ruiters, 2005).

Concessionaire takes the payment directly from the citizens and takes the risk that costs will not be more than revenues (Water Deregulation Report, 2006). Partnerships are the organizational form of networks in which public and private actors come together for delivering a service. Besides, as a policy instrument partnership is the mixture of public and private sector tools.

## Types of PPPs arrangements

Several types of contracting arrangements are used around the world to finance and deliver highway-related infrastructure projects, including roads, bridges, and tunnels. The PWF database lists various contracting approaches used or proposed for each project.

***Figure 4.*** The Spectrum of Public-Private Partnerships




*Source: FHWA PPP website www.fhwa.dot.gov/ppp/*

These contracting approaches generally fall into the following seven categories:

1. Build-Operate-Transfer/Build-Transfer-Operate (BOT/BTO) – This is a project delivery method typically involving the design, construction, finance, and operation of a facility whereby the contract team acquires ownership of the facility until the end of the construction period or the contract term, when ownership of the facility is returned to the original public sector sponsor.
2. Build-Own-Operate (BOO) – This is a project delivery method similar to BOT where the contract team both owns and operates the facility.
3. Concession – This is a contract arrangement which grants the contract team full responsibility to finance, build, operate, and/or maintain the facility as a franchisee for a specified period of time, whereby the private sector team takes most of the project and financial risks and potential rewards for the term of the Concession contract. In some cases, Concessions have been granted for the operation and maintenance of facilities built by others, as a comprehensive form of Management Contract.
4. Design-Build (DB) –The contract team is responsible for both design and construction phases of a project as part of a single contract. This is in contrast to the traditional project delivery approach used for highway projects in the United States, Design-Bid-Build (DBB), in which the design firm and the construction contractor are separately responsible for the design and construction phases of a project. Design-build contracts typically do not involve the use of private financing. However, they are still considered PPP projects because of the added responsibility and risk assumed by the private sector Design-Build team.
5. Design-Build-Operate-Maintain (DBOM) – the contract team is responsible for design, construction, operation, and maintenance of the facility for a specified period of time, where payment beyond project completion is predicated on meeting certain prescribed performance standards relating to physical condition, capacity, congestion, and/or ride quality. This is an extension of Design-Build that provides an inherent incentive for the design-builder to provide a better quality plan and project by creating a lifecycle responsibility and accountability of the performance of the facility by the design-builder.

6. Design-Build-Finance-Operate (DBFO) - This is an extension of the DBOM project delivery method in which the contract team is also responsible for financing the project and takes the risks of project financing during the contract term. This contract approach is similar to BOT/BTO becomes a Concession when the private sector team acts as a franchisee with most of the project and financial risks and potential rewards.
7. Management Contract – this is a contract arrangement under which the contract team manages the provision of specified functions at certain performance standards over a pre-identified period of time, often with the provision of subsequent time extensions to the contract. Like Design-Build, these contracts typically do not involve the use of private financing but do represent additional responsibilities and risks for the private sector asset management team. In addition to the above terms, two more contracting approaches are noted in the PWF (*Public Works Financing*) database. These include:
8. Asset Sale – when the facility is sold to a private sector team which holds full responsibility and liability for the project and its risks and returns. There are very few true Asset Sales involving highway-related facilities, so this contracting approach is included in the Concession category defined above.
9. Joint Development Agreement (JDA) – This is a contract arrangement where both the public sector sponsor and the private sector contract team enter into a joint agreement to share responsibilities for developing, financing, operating, and preserving the facility. This contract approach is used where there is strong interest by the sponsoring agency to retain a substantial portion of control over the project and interest in the proceeding of the project.

## PPP IN PRACTICE

However PPP is more than a UK policy, and has been supported in other countries around the world (Broadbent and Laughlin, 2003). PPPs have become increasingly common mechanisms deployed by governments in a variety of areas including international trade (Schuster and Lundstrom 2002) and infrastructure development. Substantial financial investment is needed to create additional infrastructure, these partnerships have been referred to as Private Finance Initiative (PFI) in the UK, as Build-Operate-Transfer (BOT) in Australia and Asia, and more generally as Project Franchises in the United States (Hall 1998, Prager 1997, Domberger and Fernandez 1999). In France, the PPP approach is called "delegated management of public services", reflecting the long held view there that public authorities and private companies should enter into a partnership for the management of safe, regular and reliable public services for citizens/consumers (Levy 1998, Domberger and Fernandez 1999).

***Figure 5.*** PPP around the world in 1999

**Kaynak:** Stephen Harris (2006)"**PPP: Key Messages for Government based on UK and International Experience"**, Uluslararası KÖSİ (PPP) Zirvesi ve Sempozyumu, Tebliğ sunumu,15.09.2006, Ankara.

***Figure 6.*** PPP around the world in 2007

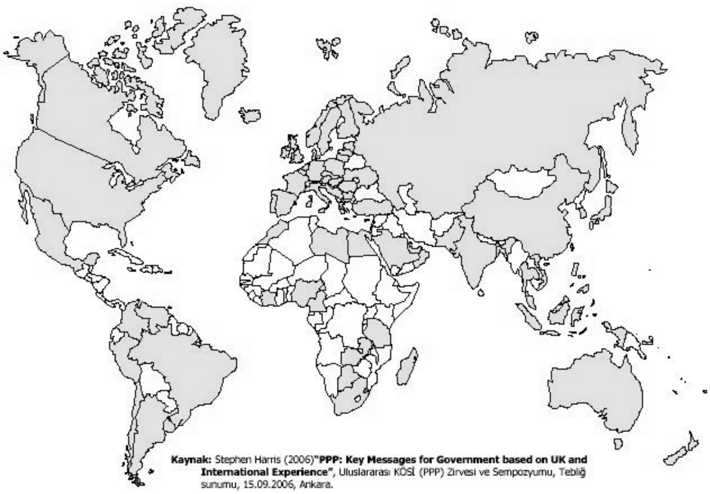
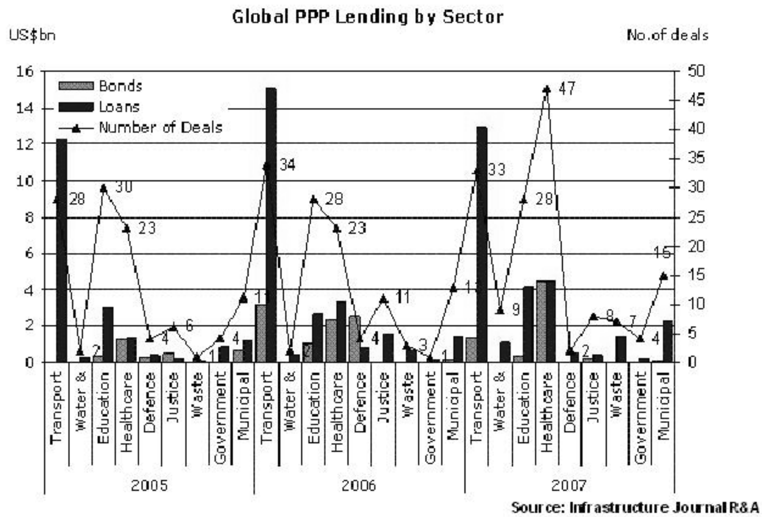



***Figure 7.*** Global PPP Lending by Sector.




PPPs may have the potential to provide infrastructure at more reasonable prices than comparative delivery through either the public sector or traditional contract arrangements, but experience to date has been mixed in some countries. Governments have tended to view the use of PPPs as a purchasing device, and with the objective of quick delivery, have risked due process and adequate public policy consideration in doing so.

## CONCLUSIONS

Today, with the continuing drive to a global economy, democratic governments are trying to link more closely their public and private corporations in an effort to make their infrastructures more effective. This activity has been referred to as centripetal politics that occurs with a centrifugal (or complexifying) society. To do this, they look toward joint ventures that bind the two types of organization together as PPPs (Yolles and Iles 2006).

The range of typical risks encountered in public infrastructure projects is specially considered, and differences to traditional project delivery arrangements are articulated. Some empirical experience on the transfer of risks under PPPs is then outlined through a case study. This analysis shows the extent to which risks were shifted to the private parties as planned, or whether risks remained with government. It is argued that while commercial risks were largely well managed, governance risks were not. It is critical to understand better the nature of risk transfers in PPPs in view of the large financial implications of these deals along with long contract terms.

For both private and public sector, the first conclusion is that opportunities for collaboration will continue to grow in the future. These partnerships are two-edged swords. Both contractors benefit if requirements are clearly specified and expectations well managed through the whole life of the relationship. But if these issues are not given the importance they deserve, the partnerships are likely to amplify overall dissatisfaction, particularly among the citizens/consumers they are designed to benefit.

PPP as a managerial and fiscal strategy to solve the problem of the developing countries formidable need for infrastructure development is still in a nascent stage, but it is clear that the government has to lead the way ( i.e. legal arrangement) if anything worthwhile is to happen. The level of investment required for infrastructure is so significant that strong, aggressive government advocacy should see it through.

It can be said that there is an increased interest in PPPs as a method of procuring public assets throughout the world, but actual use of PPPs remains limited. Adequate management of fiscal risks from PPPs is a key challenge. Doing them for the right reason and right PPPs will lead to better value for money and provide an appropriate enabling environment (public investment planning, laws, and institutions). Progress is being made but there is continuous need for capacity building in many countries.

## REFERENCES


Arnstein, S. R., (1969), A Ladder of Citizen Participation, *JAIP*, Vol. 35, No. 4, pp. 216-224.

Austin, J., Mccaffrey, A., (2002), Busıness Leadershıp Coalıtıons And Publıc-Prıvate Partnershıps In Amerıcan Cıtıes: A Business Perspective On Regime Theory, *Journal Of Urban Affaırs*, Volume 24, Number 1, pages 35–54.

Broadbent J, Laughlin R. (2003), Public private partnerships: an introduction. *Accounting Auditing & Accountability Journal* 16(3): 332 , 341.

Claver E, Llopis J, Gasco´ JL, Molina H, Conca FJ. (1999) Public administration: From bureaucratic culture to citizen-oriented culture, *International Journal of Public Sector Management* 12(5): 455 , 464.

DiGaetano, A. (1997), Urban governing alignments and realignments in comparative perspective: Development politics in Boston, Mass., and Bristol, England, 1980–1996. *Urban Affairs Review*, *32*, 844–870.

DiGaetano, A., & Lawless, P. (1999), Urban governance and industrial decline: Governing structures and policy agendas in Birmingham and Sheffield, England, and Detroit, Michigan, 1980–1997. *Urban Affairs Review*, *34*, 546–577.

Domberger, S, and Fernandez, P., (1999), Public-Private Partnerships for Service Delivery, *Business Strategy Review*, Volume 10 Issue 4, pp 29-39.

Dowding, K., Dunleavy, P., King, D., Margetts, H., & Rydin, Y. (1999), Regime politics in London local government. *Urban Affairs Review*, *34*, 515–545.

Entwistle, Tom and Martin, Steve, (2005) From Competition to Collaboration in Public Service Delivery: A New Agenda for Research, *Public Administration*, Vol. 83 No. 1, pp. 233- 242.

Franceys, R. And Weıtz, A., (2003), Public–Private Community Partnerships In Infrastructure For The Poor, *Journal of International Development, J. Int. Dev.* 15, 1083–1098

Hall, J. (1998), Private Opportunity, Public Benefit?, *Fiscal Studies*, Vol.19, No. 2, p121-140.

Hodge, G. A. and Greve, C. (2009), P P P S : The Passage Of Time Permits A Sober Reflections, *Economic Affairs*, PP. 33-39

Hofmeister A, Borchert H. (2004), Public–private partnerships in Switzerland: crossing the bridge with the aid of a new governance approach. *International Review of Administrative Sciences* **70**(2): 217–232.

http://www.worldwatercouncil.org/index.php?id=708 (15.05,2009).

Kantor, P., Savitch, H. V., & Haddock, S. V. (1997), The political economy of urban regimes: A comparative perspective. *Urban Affairs Review*, *32*, 348–377.

Keating, M. (1993), The politics of economic development: Political change and local development policies in the USA, Britain, and France. *Urban Affairs Quarterly*, *28*, 373–396.

Keating, Michael, (1998), Commentary: Public Private Partnerships in the United States from a European Perspective in Partnerships in Urban Governance: European and American Experience (ed.) Jon Pierre, Great Britain: Macmillan Press, pp. 163- 174.

Klijn E.H, Teisman G.R. (2000), Governing public–private partnerships: analysing and managing the processes and institutional characteristics of public–private partnerships. In *Public–Private Partnerships: Theory and Practice in International Perspective*,Osborne SP (ed.). Routledge: London; 84–102.

Leitch, S and Motion, J, (2003), Public-private partnerships: Consultation, cooperation and collusion, Journal of Public Affairs, Vol. 3 No. 3, pp. 273–278

Linder S.H., Rosenau P.V., (2002), *Mapping the terrain of the public–private policy partnership. In Public–Private Policy Partnerships*, Rosenau PV (ed.). MIT Press: Cambridge, MA; 1–18.

Linder, Stephen H. and Rosenau, Pauline V., 2000. "*Mapping the Terrain of the Public- Private Policy Partnership" in Public-Private Policy Partnership* (ed.) Pauline V. Rosenau. London: The MIT Press, pp. 1-19.

Linder, Stephen H., (2000), *Coming to Terms with the Public Private Partnership: A Grammar of Multiple Meanings in Public-Private Policy Partnership* (ed.) Pauline V. Rosenau. London: The MIT Press, pp. 19-36.

McDonald, David A. and Ruiters, Greg, (2005), *Rethinking Privatization: Towards a Critical Theoretical Perspective in Public Services Year Book 2005/2006*, pp. 9-20. (http://www.tni.org/books/yearb05theory.pdf)

McLaughlin K, Osborne S.P., (2000), *Conclusions: a one-way street or two-way traffic? Can public–private partnerships impact on the policy-making process? In Public Private Partnerships: Theory and Practice in International Perspective*, Osborne SP (ed.). Routledge: London; 324–338.

Mcquaid, Ronald W., (2000) *The Theory of Partnership: Why have partnerships? in Public Private partnerships for Public Services: An International Perspective (ed.) Stephen Osborne, London: Routledge Press, pp. 9- 35.*

Osborne, David and Gaebler, Ted, (1993), *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*. England: Penguin Books Ltd.

Pongsiri, Nutavoot, (2002), Regulation and Public-Private Partnerships, *The International Journal of Public Sector Management*, Vol. 15 No. 6, pp. 487-495.

Prager, J (1997), Contracting Out as a Vehicle for Privatization: Half Speed Ahead, *Journal of International Affairs*, Vol. 50, No. 2, p 613-632.

Radin, Beryl A., (1998), *Bridging Multiple Worlds: Central, Regional and Local Partners in Rural Development in Partnerships in Urban Governance: European and American Experience* (ed.) Jon Pierre, Great Britain: Macmillan Press, pp. 140- 162.

Regéczi, D. (2005), Limited Partnership: The Lack of Sustainable Development in Relation to Participation in Hungarian Public–Private Partnerships, *Business Strategy and the Environment, 14*, 205–215

Savas E.S. (1982), *Privatizing The Public Sector: How to Shrink Government*. Chatham House: Chatham NJ.

Schuster, C. and Lundstrom, W. (2002), Public private Partnerships in International Trade: A Lobbying Effort from Passive to Aggressive in the USA?, Journal *of Public Affairs*, 2(3): 125– 135.

Stone, C. N. (1993). Urban regimes and the capacity to govern: A political economy approach. *Journal of Urban Affairs*, *15*, 1–28.

Teisman GR, Klijn E-H. (2003), Institutional and strategic barriers to public–private partnership: an analysis of Dutch cases. *Public Money and Management* 23(3): 137–146.

Weizsacker, E. and Young, Oran and Finger, Matthias, (2005), *Limits to Privatization in Limits to Privatization: How to Avoid Too Much of A Good Thing* (eds.) Ernst von Weizsacker and Oran Young and MatthiasFinger, UK: Earthscan Publications, pp. 3- 14.

Yolles, M. and Iles, P., (2006), Exploring Public–Private Partnerships through Knowledge Cybernetics, *Systems Research and Behavioral Science*, 23, 625-646

National Council of the Institute of Public Administration, Australia 2004

## *NAME INDEX*